LE COPY

72-58

Supreme Court, U. S.
FILED
JUL 10 1972
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

NO. _____

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
Petitioner

v.

NORMAN L. HARWELL, et al

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Lloyd J. Derrickson
Frank J. Wilson
1735 K Street, N. W.
Washington, D. C. 20006

Joel H. Pullen
DAVIS, O'CONNOR & PULLEN
1515 National Bank of Commerce Building
San Antonio, Texas 78205

COUNSEL FOR PETITIONER

INDEX

	Page
OPINIONS BELOW	1
STATEMENT OF GROUNDS ON WHICH THE JURISDICTION OF THE SUPREME COURT IS INVOLVED	2
QUESTIONS PRESENTED	
1. Whether the actions of the Petitioner Association complained of herein are cloaked with specific antitrust immunity under 15 U.S.C. 78o-3(n) a provision of the Maloney Act. This important question of federal law has not been, but should be, settled by this Court.	2
2. Whether the decision of the Court of Appeals in this case is in conflict with this Court's decision in Silver v. New York Stock Exchange, 373 U.S. 341 (1963)	3
3. Whether the Court of Appeals erred in applying the standards of Thill Securities Corporation v. New York Stock Exchange, 433 F. 2d 264 (7th Cir. 1970) to this case in view of the numerous differences in the facts and in the actual and statutorily required supervision by the Securities and Exchange Commission as between national securities exchanges and national securities associations.	3
4. Whether the Securities and Exchange Commission in the exercise of its congressionally delegated responsibility of oversight over national securities associations, including the performance of a duty under the	

Maloney Act to determine prior to their effectiveness whether all rules of such an association are consistent with that Act (15 U.S.C. 78o-3(j)), must make a "record" showing that it considered potential antitrust aspects of the contemplated rule. What are the substantive requirements of such a record, if one is required? 3

5. Whether when Congress has established a regulatory scheme, including express statutory provisions for review of a rule or its implementation as it has done in connection with the Maloney Act (15 U.S.C. 78o-3(g), (j), (k)), an aggrieved person may willfully bypass the statutorily prescribed procedures and resort instead to action in the federal District Court. Whether plaintiffs should have sought review initially by the Securities and Exchange Commission by a Petition for Abrogation of the Interpretation here in question with an ultimate statutory right of appeal to the United States Court of Appeals. Whether the Association's Motion to Dismiss for lack of jurisdiction for failure of plaintiffs to exhaust their administrative remedies should have been granted. 3

6. Whether the Court of Appeals erred in holding that the Interpretation was a "new rule", instead of the application of an existing rule that had been in effect for twenty-six years prior to the time plaintiffs purchased their programs. 4

STATUTES INVOLVED 4

STATEMENT OF CASE 4

ARGUMENT

1. The Association has received antitrust immunity by virtue of Section (n) of the Maloney Act. 13

2. The decision of the Fifth Circuit conflicts with this Court's decision in Silver v. New York Stock Exchange 19

3. The Court of Appeals erred in applying the principles of Thill Securities Corporation v. New York Stock Exchange to this case. 19

4. The Securities and Exchange Commission does not have to make a record of antitrust consideration of proposed rule. 26

5. The Securities and Exchange Commission has primary jurisdiction -- Plaintiffs failed to exhaust their administrative remedies. 27

6. The Interpretation is not a new rule. 28

CONCLUSION 31

TABLE OF AUTHORITIES

Cases	Pages
Columbia Broadcasting System v. United States, 316 US 407	31
Far Eastern Conference v. United States, 342 US 570 (1952)	28
Federal Communications Commission v. Schrecker, 381 US 279 (1969)	28
Samuel B. Franklin v. Securities and Exchange Commission, 290 F. 2d 719 (9th Cir. 1961) cert. den. 368 US 889	29
Handley Investment Company v. Securities and Exchange Commission, 354 F. 2d 65 (1965)	29
R. H. Johnson & Co., v. Securities and Exchange Commission, 198 F. 2d 690 (C.A. 2nd Cir. 1952) cert. den. 344 U.S. 855	21
Machinists v. Street, 367 US 740 (1961)	14
Myers v. Bethlehem Shipbuilding Corp., 301 US 41 (1938)	28
Philadelphia Co. v. Securities and Exchange Commission, 164 F. 2d 889 (D. C. Cir. 1948)	28
Reisman v. Caplan, 375 US 440 (1964)	28
Securities and Exchange Commission v. Chenery Corp., 332 US 194 (1947)	31
Silver v. New York Stock Exchange, 373 US 341 (1963)	3, 12, 13, 14, 19, 20, 22, 25, 26, 27
Thill Securities Corporation v. New York Stock Exchange, 433 F. 2d 264 (7th Cir. 1970)	3, 13, 22

United States v. Morgan, 118 F. Supp. 621 (S.P. N.Y. 1953) 14

United States v. Philadelphia National Bank, et al, 347 US 321 (1963) 28

United States v. Sacony Vacuum Oil Co., 31 US 150 (1940) 14

Securities and Exchange Commission Decisions

Bailey & Co., Sec. Ex. Act Rel. No. 7241 (1964) 29

First California Co., 40 SEC 768 (1961) 29

R. J. Gabriel & Co., Inc., Sec. Ex. Act Rel. No. 7696 (1965) 29

Guardian Investment Corporation, Sec. Ex. Act Rel. No. 7239 (1964) 29

In re National Association of Securities Dealers, Inc., 5 SEC 627 (1939) 5, 6

In re National Association of Securities Dealers, Inc., 17 SEC 459 (1944) 29

Rentz & Company, Inc., Sec. Ex. Act Rel. No. 8314 (1967) 29

L. H. Rothschild & Co., Sec. Ex. Act Rel. No. 7182 (1963) 29

Valley Forge Securities, Inc., Sec. Ex. Act Rel. No. 7055 (1963) 29

Statutes

Investment Company Amendments Acts of 1970, 15 USC 80a-22(h)(4) 15

Maloney Act

15 USC 78o-3(a) through (n) 3, 4
15 USC 78o-3(b)(1) through (12) 5, 22
(b)(3) 18
(b)(8) 5, 13, 26
(b)(9) 5, 28
(b)(10) 5, 28
(g) 3, 21, 28
(h) 21, 28
(j) 3, 5, 22, 27
(k) 3
(n) 2, 3, 14, 15 22

Securities Exchange Act of 1934 3

15 USC 78f 22
78s(b) 22
78y 21, 28

28 USC 1332 (a)(1) 11

Texts

2 American Jurisprudence Administrative Law §299 30

Appendix, Congressional Record, January 10, 1938 - Reprint of speech made by Mr. Justice Douglas at Hartford, Conn., January 7, 1938 17

Loss, Securities Regulation, Vol. II, Chapter 803 15

Report of Securities and Exchange Commission on Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2nd Sess. 26-27, 304-305 25

Senate Report No. 379, 88th Cong., 1st Sess. (1963) 5, 18

Senate Report No. 91-184, 91st Cong., 2nd Sess. (1970) 15

Special Study of Securities Markets, H. Doc. No. 85, 88th Cong., 1st Sess. (1963) 5

Other

By-Laws of National Association of Securities Dealers, Inc.

Article I, Section 4(a) 6
Article IV, Section 2 6
Article VII, Section 3(a) 6

Rules of Fair Practice of NASD

Article III, Section 1 6, 29, 30

Interpretations of Rules of Fair Practice

Advertising, Sales Literature and Recruiting of Sales Personnel 29

Contractual Withdrawal Plan and Reinvestment 2, 4, 6, 7, 10, 16, 23-26, 28, 29, 31

Free-Riding and Withholding 29

Markup Policy 29, 30

Federal Rules of Civil Procedure

Rule 56 8

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

NO. _____

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
Petitioner

v.

NORMAN L. HARWELL, et al

PETITION FOR A WRIT OF
CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Petitioner, NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on October 15, 1971, and on Petition for Rehearing and/or Rehearing In Banc on April 11, 1972.

OPINIONS BELOW

The Opinion of the Court of Appeals (Appendix A) is reported at 451 F. 2d 240. The Opinion of the Court of Appeals on Petition for Rehearing and/or Rehearing In Banc is as yet unreported but is attached hereto as Appendix B. The Opinion of the District Court for the Western District of Texas is reported at 315 F. Supp. 1184 and is attached hereto as Appendix C.

STATEMENT OF GROUNDS ON WHICH THE JURISDICTION OF THE SUPREME COURT IS INVOLVED

The judgment of the Court of Appeals was entered on the 15th day of October, 1971. On April 11, 1972, the Court of Appeals entered its order on Petitioner's Motion for Rehearing In Banc. This Petition for Certiorari was filed less than ninety days from the last date aforesaid. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254 (1).

QUESTIONS PRESENTED

Plaintiffs, representing a class of 1,258 holders of certificates of a single investment program, a contractual program for the accumulation of shares of an investment company, (hereinafter called "program") brought this action against the program's sponsor, GROWTH PROGRAMS, INC. ("Growth"), who sold through other broker/dealers the programs to plaintiffs; its parent, SUPERVISED INVESTORS SERVICES, INC. ("Supervised") and, by amendment to its complaint two years after the the action was initially instituted, against Petitioner NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. (hereinafter "Petitioner", "Association" or "NASD") for damages purportedly arising because Growth and Supervised ceased to assist plaintiffs in their misuse of a "withdrawal and reinvestment privilege" (the "Privilege") contained in their programs because of an interpretation of its Rules of Fair Practice issued by the Association (Appendix D) subsequent to specific approval of the Securities and Exchange Commission (Appendix E). The complaint requested declaratory relief, injunctive relief, damages under the antitrust laws and damages for tortious interference with contract. All parties filed Motions for Summary Judgment. Defendants' motions were granted and plaintiffs' motion was overruled by the District Court. The Court of Appeals for the Fifth Circuit reversed the District Court's action and remanded the case for further proceedings. The questions thereby arising are:

1. Whether the actions of the Petitioner Association complained of herein are cloaked with specific antitrust immunity under 15 U.S.C. 78o-3(n) a provision of

the Maloney Act. 1/ This important question of federal law has not been, but should be, settled by this Court. That section provides as follows:

> (n) If any provision of this section [the Maloney Act] is in conflict with any provision of any law of the United States in force on June 25, 1938, the provisions of this section shall prevail.

2. Whether the decision of the Court of Appeals in this case is in conflict with this Court's decision in Silver v. New York Stock Exchange, 373 U.S. 341 (1963).

3. Whether the Court of Appeals erred in applying the standards of Thill Securities Corporation v. New York Stock Exchange, 433 F. 2d 264 (7th Cir. 1970) to this case in view of the numerous differences in the facts and in the actual and statutorily required supervision by the Securities and Exchange Commission as between national securities exchanges and national securities associations.

4. Whether the Securities and Exchange Commission in the exercise of its congressionally delegated responsibility of oversight over national securities associations, including the performance of a duty under the Maloney Act to determine prior to their effectiveness whether all rules of such an association are consistent with that Act (15 U.S.C. 78o-3(j)), must make a "record" showing that it considered potential antitrust aspects of the contemplated rule. What are the substantive requirements of such a record, if one is required?

5. Whether when Congress has established a regulatory scheme, including express statutory provisions for review of a rule or its implementation as it has done in connection with the Maloney Act (15 U.S.C. 78o-3(g), (j), (k)), an aggrieved person may willfully bypass the statutorily prescribed procedures and resort instead to action in the

---

1/ The Maloney Act amended the Securities Exchange Act of 1934 and became Section 15A thereof. (15 U.S.C. 78o-3(a) through (n))

federal District Court. Whether plaintiffs should have sought review initially by the Securities and Exchange Commission by a Petition for Abrogation of the Interpretation here in question with an ultimate statutory right of appeal to the United States Court of Appeals. Whether the Association's Motion to Dismiss for lack of jurisdiction for failure of plaintiffs to exhaust their administrative remedies should have been granted.

6. Whether the Court of Appeals erred in holding that the Interpretation was a "new rule", instead of the application of an existing rule that had been in effect for twenty-six years prior to the time plaintiffs purchased their program.

STATUTES INVOLVED

This case involves the Maloney Act (15 U.S.C. 78o-3(a) through (n)), an amendment to the Securities Exchange Act of 1934, 15 U.S.C. 78a, et seq., and the actions of Petitioner in exercising regulatory authority delegated to it by Congress in that Act.

STATEMENT OF THE CASE

Petitioner, NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., is the only national securities association registered under the Maloney Act. The purpose of the Maloney Act as stated in its preamble is:

> To provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers operating in interstate and foreign commerce or through the mails to prevent acts and practices inconsistent with just and equitable principles of trade and for other purposes.

The Association registered with the Commission as a national securities association on August 7, 1939. (In re National Association of Securities Dealers, Inc., 5 SEC 627 (1939)) It engages primarily in regulatory activities "govern[ing] conduct in the over-the-counter [securities] markets" (Special Study of Securities Markets, H. Doc. No. 95, 88th Cong., 1st Sess., Pt. 4, p. 603), is created pursuant to statute and operates under close oversight of the Securities and Exchange Commission. (Senate Rep. No. 379, 88th Cong., 1st Sess., p. 42 (1963)) Its rules and regulations must be submitted to the Commission before they can become effective. If they are not consistent with the provisions of the Maloney Act they must be disapproved by the Commission and cannot become effective. (15 U.S.C. 78o-3(j))

The Maloney Act specifies various requirements which must be met before an association may be registered under its provisions. These are set out primarily in 15 U.S.C. 78o-3(b)(1) through (12). Particularly involved here are the provisions of the Maloney Act which require that the Association's rules be designed

> . . . to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest; and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers, or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule of fixed minimum rates of commissions, allowances, discounts, or other charges. (15 U.S.C. 78o-3(b)(8))

Enforcement of the Association's rules is by discipline of its members (15 U.S.C. 78o-3(b)(9) and (10)). At the present time there are approximately 4,400 members of the Association. Defendants Growth and Supervised were and are such members, as are some of

the members of the plaintiff class. Such members are contractually bound by their membership agreements with the Association (which agreements were in existence prior to plaintiffs' purchases of their programs) to comply with and adhere to the Association's Certificate of Incorporation, By-Laws and Rules of Fair Practice. (CCH, NASD Manual, By-Laws, Article I, Section 4(a), ¶ 1104). Section 1 of Article III of the Association's Rules of Fair Practice (CCH, NASD Manual, Rules of Fair Practice, Section 1, ¶ 2151) states as follows:

> A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

This rule has been in existence since 1939 (In re National Association of Securities Dealers, Inc., 5 SEC 627 (1939)), approximately twenty-six years prior to the time plaintiffs began purchasing their programs in 1965 from Growth.

The Association's By-Laws in Article IV, Section 2 (CCH, NASD Manual, ¶P 1402) specifically gave to its Board of Governors the power to make such interpretations of the Association's rules as are deemed necessary or appropriate. Article VII, Section 3(a) of the Association's By-Laws (CCH, NASD Manual, ¶P 1503) further specifically reiterates the power to "make and issue interpretations of all such rules of fair practice." The Interpretation in this case (Appendix D) was issued pursuant to this power.

Growth is the wholly-owned broker/dealer subsidiary of defendant Supervised and is the sponsor of sales of program certificates in Growth. Program certificates evidence an investor's pro rata interest in a program company's (in this case Growth's) portfolio which is composed entirely of shares of a mutual fund -- in this case Technology Fund, Inc.

Supervised is a broker/dealer engaged in the general securities business and is the investment manager of the portfolio of Technology Fund. Both Growth and

Supervised are and have been members of the Association. No contracts exist between the Association and any of the plaintiff class other than such of them as are members of the Association.

The named plaintiffs and the members of the class they represent constitute 1,258 persons. All of them purchased programs with the Privilege (described below) from Growth, generally through other broker/dealers. There are 110,000 other shareholders in Technology Fund. These persons own mutual fund shares of Technology directly as distinguished from programholders who own a certificate representing an interest in Growth's portfolio which is made up of mutual fund shares of Technology. The Interpretation in question was issued by the Association to stop the misuse of the Privilege which was being engaged in by certain members of the plaintiff class for rapid short-term speculation to the detriment of the 110,000 shareholders who did not possess the Privilege. In executing the abusive scheme the plaintiff class was materially assisted by broker/dealer members of the Association and they undoubtedly could not have executed the scheme without their assistance.

The program applications which were executed by plaintiffs (copies of which are part of the record) and the prospectus under which they purchased clearly state the Privilege was not to be unlimited in nature since such documents specifically provided over an applicant's signature "I understand this is a long term investment program, not designed for quick profit." (NASD Ex. 3, p. 1060) 2/

The Association issued the Interpretation because it believed the improper use of the Privilege by the plaintiffs created several serious problems, among which was the dilution of the interests of the 110,000 other shareholders in the fund. This dilution has never been denied, although the Court of Appeals erroneously referred to it as an "alleged dilution." Since the affidavits showing dilution

2/ Record citations are to the record below.

were not denied, the facts therein stated are uncontroverted for purposes of Summary Judgment (Rule 56, F.R.C.P.) The determination of whether dilution occurred is a simple arithmetic problem.

The Interpretation was designed to prevent members of the Association from participating in misuse of the Privilege and the consequent dilution and adverse effects of such misuse on other fund shareholders. The Interpretation applies to all of the Association's members and prevents them, among other things, from assisting a programholder in exercising his privilege under the program more than once per year. By doing so, it effectively prevented the programholders from exercising the privilege on an "in and out" basis because they relied on the expertise of the broker/dealers in determining swings (upturns or downturns) in the market.

The Privilege permitted a programholder to withdraw in cash up to 90% of the value of his investment in the program at the net asset value of the underlying mutual fund shares (Growth's portfolio) at the time of withdrawal and to reinvest such amounts at any future time at the net asset value of the fund shares at the time of the reinvestment without the payment of an additional sales charge. 3/ (Without the privilege a sales commission would be required on the reinvestment.) Thus, if the net asset value had declined after withdrawal and before reinvestment by a programholder, he would obtain more shares upon reinvestment than he previously had. Conversely, if the value increased, he would obtain fewer shares upon reinvestment. Plaintiffs always attempted to anticipate a decline in net asset value. This was reasonably predictable at that time because of the pricing system then used. The net asset value was recomputed and changed twice daily. An appreciation of the significance of this is necessary to a complete understanding of the plaintiffs' misuse of the

3/ Net asset value -- the value on a per share basis of the securities holdings and cash held in the portfolio of a mutual fund --- in this case Technology Fund, Inc.

privilege. These computations were made by the mutual fund as of a given time, 1:00 p.m. and 3:30 p.m., but did not become effective until one hour later, 2:00 p.m. and 4:30 p.m. This allowed a sale or reinvestment at the last net asset value until the new value became effective. The new price was not prior to its effectiveness publicized by the mutual fund, but a broker, such as plaintiff Stewart, a broker/dealer member of the Association, representing by power of attorney many of the other class plaintiffs who closely watched the market and concerned himself with knowing the portfolio held by the mutual fund (Technology) could compute it with a reasonable degree of accuracy because the closing prices (the market closes at 3:30 p.m.) are known to him. If he determined that the net asset value would be lower he could, for example, issue sell orders for his clients anytime between 3:30 p.m. and 4:30 p.m. and after the new price is established at 4:30 p.m. immediately repurchase for his clients who would now own more shares. No sales charge is involved. Because a mutual fund share represents a pro rata interest in the portfolio of the mutual fund, the holdings of all of the other shareholders in the fund would have, as a result of such activity, been proportionately diluted.

The privilege in plaintiffs' programs also permitted orders for withdrawal and reinstatement to be made by telephone, teletype or telegraph to the custodian bank. This differed from the usual practice which required receipt by the custodian bank of an order in writing before a withdrawal or reinstatement could be executed. This extension of the privilege in plaintiffs' contracts enabled a programholder to redeem or reinvest at the net asset value per share as of the time the telephone or wire order was received, subject to subsequent confirmation in writing. It, in effect, froze the price as of the time of a telephone call, notwithstanding that the order could not be executed until the written order was received. This could not be done if the order had to go through the mail because the price may have changed several times before the mailed order arrived. As noted, if a broker like plaintiff Stewart closely followed the market and the mutual fund's portfolio and ascertained just before the new price became effective that it would be lower, he could by a telephone call with-

draw 90% of the value of his or his customers' shares and immediately reinvest with another telephone call at the lower price after it became effective. Withdrawals and reinvestments were made in this fashion at frequent intervals by many of the plaintiffs through their broker/dealer exercising a power of attorney for them. Thus, one telephone call by a broker/dealer could withdraw or reinvest for scores of clients. Hundreds of thousands of dollars were withdrawn or reinvested in this manner by one telephone call. The net effect of this in and out activity was, as stated, to dilute the proportionate ownership of shareholders who did not have the Privilege in the underlying mutual fund assets. Plaintiffs have not denied that they were playing the "short swings" of the market and have not denied the dilutive effects of their actions. Plaintiffs were in a preferred position as compared to the 110,000 other investors in Technology Fund. The Interpretation prevented further dilution of the holdings of these 110,000 shareholders and the further aggrandizement of the 1,258 members of the plaintiff class at their expense.

The Interpretation was drafted after the Association, various members of its Investment Companies Committee, other securities industry organizations and the Securities and Exchange Commission staff all became aware of the misuse of the Privilege and its harmful effects. (NASD Exh. 16, at 3-4, Affidavit of Mr. Rowland A. Robbins, member of Association's Investment Companies Committee. President of the Association of Mutual Fund Plan Sponsors, Inc., Ratzlaff Dep. pp. 8 and 11, NASD Exh. 19; Ratzlaff Dep., p. 18; NASD Exh. 17C) It was drafted by the Association's staff, members of its Investment Companies Committee and members of the Securities and Exchange Commission's staff after several meetings at the offices of the Commission all of which are detailed in the record. Its issuance was subsequently approved by the Association's Board of Governors and thereafter by the Securities and Exchange Commission itself which suggested certain changes. (Appendix E)

(Ratzlaff Dep., p. 18; NASD Exh. 17C; NASD Exh. 17B; Ratzlaff Dep., p. 19; NASD Exh. 2) The effectiveness of the Interpretation is undisputed, and thereafter the Privilege could only be used in accordance with its traditional purpose, namely to allow a person with a bona fide financial need to liquidate his fund holdings and to reinvest them when the need was past, without being required to forfeit the substantial sales commission deducted from their initial payments or pay an additional commission on the reinvestment. (NASD Exh. 16, Affidavit of Mr. Rowland A. Robbins, member of the Association's Investment Companies Committee, President of the Association of Mutual Fund Plan Sponsors, Inc.) After enactment, its effectiveness was delayed for fourteen months upon Growth's representation that the abuse would be eliminated by "attrition." That did not occur whereupon it was strictly enforced. This proceeding was commenced during the first month of that fourteen-month period. Plaintiffs did not request a hearing before the Association or the Commission during that period. The Association was not made a party until two years later. The basis for Federal jurisdiction relied on by plaintiff is 28 USC 1332(a)(1). All parties filed Motions for Summary Judgment and Plaintiffs' Motion for Summary Judgment was overruled, and those of the Association and of the other defendants were granted. The Court of Appeals, stating that it made no "final determination" of the questions, reversed and remanded the case finding that several factual issues needed resolution. The Securities and Exchange Commission filed an amicus curiae brief defending the Association's Interpretation as being clearly within its power under the Maloney Act, that it was not promulgated in violation of the due process of law, and that the issuance of an Interpretation of existing Rules of Fair Practice by the Association, with SEC concurrence, did not constitute a violation of the antitrust laws.

Notwithstanding that the Court stated it made no "final determination" of the questions involved, certain language in its decision, especially in relation to the application of the antitrust laws to the Association, states its opinion of the law and thus would bind the District Court in a trial of the cause. The Association believes it has misconstrued the law in this respect and since this

that there was in existence at that time no authoritative decision as to the extent of antitrust immunity of the Association under the provisions of 15 USC 78o-3(n) (Appendix A-5) which provides as follows:

> "(n) If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provisions of this section shall prevail."

This provision on its face is clear and unambiguous, yet the Court of Appeals seems to have written it out of the Act by equating with it the implied repealer doctrine of Silver (discussed hereafter in Point 2) in the language quoted above at pages 12-13. Several decided cases have referred to this section in dicta but no case had directly ruled on its effect. All prior writings on the subject had unanimously concluded that it was intended to lift the ban of antitrust laws against conduct of the NASD performed, and rules adopted, pursuant to the provisions of the Maloney Act.[4/] No statement to the contrary

---

4/ United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) [fn 60 in Justice Douglas, opinion p. 227]; Machinists v. Street, 367 U.S. 740 (1961); [fn. 16 in Justice Frankfurter's dissenting opinion, p. 809]; United States v. Morgan, 118 F.Supp. 621 (S.D. N.Y. 1953) ["By express statutory provision, Securities Exchange Act of 1934, Section 15(a) (n), the Rules of Fair Practice of the NASD are, when approved by the SEC, exempt from the application of the antitrust laws, if in conflict. This is not disputed." Judge Medina's opinion, p. 693]; Silver v. New York Stock Exchange, 302 F.2d 714 (1962);, rev'd 373 U.S. 341 (1962) ["In other provisions of the Securities Exchange Act; namely those sections governing over-the-counter brokers' and dealers' associations, 52 Stat 1070 (1938), 15 U.S.C.A. §780-3, the draftsmen of our securities statutes provided an explicit exemption from the antitrust laws. 15 U.S.C.A. §780-3(n)." Judge Waterman's dissenting opinion, p. 772]; Silver v. New York Stock Exchange, 196 F.Supp. 209 (S.D. N.Y. 1961), ["Moreover, in the

can be found. New law has been made by the Court of Appeals which is contrary to all prior writings on the subject.

If there is any question about the meaning of Section (n), Congress recently restated its intent in connection with its adoption of the Investment Company Amendments Act of 1970. That Act contained a provision identical to the above section with the exception of the date. It states:

> (4) If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. (15 USC 80a-22(b)(4))

The Senate Report states the intent of this provision as follows:

> The provisions of this proposed section shall prevail over any conflicting provision of Federal law. This provision, which is identical to Section 15A(n) of the Securities Exchange Act [the Maloney Act provision set out above], is designed to make it clear that no other provision of Federal law, including the antitrust laws, prevents a registered securities association from adopting rules consistent with, and necessary to effectuate, the purposes and provisions of this section. (S. Rep. No. 91-184, 91st Cong., 2nd Sess. p. 18 (1970)) (Emphasis added)

1938 amendment Congress expressly provided that in the event of conflict between any provisions of the 1938 Act and any other provision of law, the provisions of the 1938 Act should prevail. 15 U.S.C.A. §780-3(n). This, of course, includes the antitrust laws." (Judge Bryan's opinion, p. 220); See Loss, Securities Regulations, Vol. II, Chapter 8C3 "The Maloney Act and the Anti-Trust Laws." p. 1369.

Because of the wide scope of the Association's regulatory obligations, the question of the application to it of the antitrust laws and the effect of Section (n) in respect thereto should be decided by this Court. The Association must know whether such laws apply and, if so, the extent thereof. Such knowledge is essential if it is to properly and vigorously carry out its delegated regulatory responsibilities under the Maloney Act. This is a matter of crucial importance if the Association is to be a vigorous rather than a timid regulator.

If the decision of the Court of Appeals is allowed to stand, the adoption and enforcement by the Association of a rule could result in potential antitrust liability even when there was close consultation and cooperation with the Commission in connection with the adoption or interpretation of a regulation and even when express approval has been given by it that the contemplated action is consistent with the provisions of the Maloney Act as it is required to do under that Act and as was done in this case in connection with the Interpretation here in question.5/ If the Commission failed to exercise properly its statutory supervisory oversight (a situation over which the Association has no control and which oversight is manifestly greater than is required by statute of the Commission over exchanges) the Association would nevertheless have potential treble damage liability even though it complied fully with the Commission's requirements in the adoption of the regulation, which pursuant to the law it must do. The obligation the Commission has in reviewing a regulation proposed to be enacted by the Association is to determine pursuant to 15 USC 78o-3(j) whether it is "consistent with the requirements of subsection (b) and subsection (d)" of the Maloney Act. It has done that in this case. Nothing else is required of it or the Association and the Association should be relieved of potential

---

5/ In this case, the Commission and its staff actually participated in the drafting of the Interpretation.

antitrust liability upon the performance by the Commission of that function.

The broad scope of the authority granted to registered securities associations under the Maloney Act is clearly indicated by the following statement of Mr. Justice Douglas, who was the Chairman of Securities and Exchange Commission at the time it sponsored the passage of the Maloney Act. He succinctly summarized the intended purpose of the Association, its scope and its self-regulatory and disciplinary functions as follows: (Appendix, Congressional Record, January 10, 1938, p. 68, Reprint of speech made at Bond Club of Hartford, Conn., January 7, 1938)

> "I refer to effective self-government among the brokers and dealers of the country. By self-regulation I do not mean private law-making...I do mean, first, self-discipline and conformity to law -- voluntary law obedience so complete that there is nothing left for government representatives to do; second, I mean obedience to ethical standards beyond those any law can establish. I mean the form of organization of the general kind -- but with 1938 improvements -- which exchanges have evolved over a long period of time. I mean groups organized under federal auspices and operated under supervision with ample contractual powers over members to enable them to take a hand in enforcing the law..." (Emphasis added)

The exchanges and the Association cannot be compared on a parallel basis in applying the antitrust laws because the laws regulating them are different. The Fifth Circuit has apparently so compared them, however. Commission oversight over the Association is much more pervasive. (See ~~Question~~ Point 2 infra) Also not unimportant is the fact that there is no restriction on membership in the Association. All broker/dealers engaged in the securities business can become members and the Association is powerless to prevent them from doing so if certain mimimum standards, spelled out in the statute, have been

complied with. (15 USC 78o-3(b)(3)) The "private club" atmosphere of exchanges is not present.

In this connection, the Committee on Banking and Currency of the United States Senate stated as follows in 1963: (Senate Rep. No. 379, 88th Cong., 1st Sess. p. 42 (1963))

> "Registered securities associations are not private clubs. They are organized under statutory authority to perform, under governmental oversight, regulatory functions in the over-the-counter securities market." (Emphasis added)

The Committee further stated at page 42 as follows in emphasizing the importance of national securities associations being aggressive and effective:

> "A significant part of the regulation of the securities markets provided in the Securities Exchange Act is based upon the concept of self-regulation by industry organizations, under the supervision of the [Securities and Exchange] Commission. This philosophy was notably reaffirmed in 1938, when Congress enacted section 15A of the Act [the Maloney Act]. This extensive reliance on self-regulation rests on two principal premises first it provides an alternative to a much more pervasive direct regulation by the government, which would be expensive to the taxpayer and burdensome to the industry, and it also provides a more sensitive effective device for regulation in the area of unethical as distinct from illegal conduct. The Report of the Special Study has recommended that the responsibilities of self-regulatory agencies be substantially expanded and that their regulation be made more vigorous and effective." (Emphasis added)

It is submitted that insofar as any conflict with antitrust laws is concerned and the aggressiveness with which it

desires the Association to act in carrying out the responsibilities it has been given by it, Congress had made its desires crystal clear.

2. The Decision of the Fifth Circuit Conflicts With this Court's Decision in Silver v. New York Stock Exchange

3. The Court of Appeals Erred in Applying the Princples of Thill Securities Corporation v. New York Stock Exchange to This Case

The Fifth Circuit did not follow Silver v. New York Stock Exchange, 373 U.S. 341 (1963) in ruling on this case. It failed to recognize the differences in the laws applicable to national securities associations and national securities exchanges (there are substantive differences) and the much more extensive supervision over associations than exchanges by the Securities and Exchange Commission. As a result, it misapplied the implied repealer doctrine of Silver to this case which involves an express repeal.

In Silver the question presented was "whether the New York Stock Exchange is to be held liable to a non-member broker/dealer under the antitrust laws or regarded as impliedly immune therefrom when, pursuant to rules the Exchange has adopted under the Securities Exchange Act of 1934, it orders a number of its members to remove private direct telephone wire connections previously in operation between their offices and those of the non-member, without giving the non-member notice, assigning him any reason for the action or affording him an opportunity to be heard." (373 US 343) (Emphasis added)

Thus, the issue was whether the provisions of the Securities Exchange Act of 1934 relating to stock exchanges impliedly repealed the antitrust laws insofar as exchange actions are concerned. No provision such as Section (n), cited above, was involved. This Court resolved the issue in Silver by the application of doctrines of construction applicable to the situation of statutory silence. It stated that since there was no express exception from the antitrust laws, any repeal must be by implication. The following quotation from Silver focuses upon the primary distinction between this case and Silver:

> The Securities Exchange Act contains no express exemption from the antitrust laws or, for that matter, from any other statute. This means that any repealer of the antitrust laws must be discerned as a matter of implication and '[i]t is a cardinal principle of construction that repeals by implication are not favored.' ... Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary. (343 U.S. 35)) (Citations omitted)

The opposite situation is presented in this case because of Section (n). This case must, therefore, be decided on the basis of the express language of Section (n).

Silver did not involve the Maloney Act. The actions of the exchanges are not subject to the pervasive supervisory oversight and review by the Securities and Exchange Commission which is required by the Maloney Act as to national securities associations. In Silver, the Court specifically focused on the Commission's limited jurisdiction over exchanges in reaching its determination. It stated:

> Although the Act gives the Securities and Exchange Commission the power to request exchanges to make changes in their rules ... and, impliedly, therefore, to disapprove any rules adopted by an exchange ... it does not give the Commission jurisdiction to review particular instances of enforcement of exchange rules. (353 US 357) (Citations omitted)

And,

> The absence of Commission jurisdiction, besides defining the limits of the inquiry, contributes to its solution. There is nothing built into the regulatory scheme which performs the antitrust functions of insuring that an exchange will not in some cases apply its rules so as to do injury to competition which cannot be justified as furthering legitimate

> self-regulative ends. By providing no agency check on exchange behavior in particular cases, Congress left the regulatory scheme subject to "the influences of ... [improper collective action] over which the Commission has no authority but which if proven can only hinder the Commission in the tasks with which it is confronted." 353 US 358 (Citations omitted)

In footnote 12, however, the Court clearly indicated that a different result might obtain if the action of the New York Stock Exchange had been subject to Commission jurisdiction and ultimate judicial review. It specifically referred to the Maloney Act as an example of a statute complying with this requirement. The Court stated in that connection at page 358 as follows:

> Were there Commission jurisdiction and ensuing judicial review for scrutiny of a particular exchange ruling, as there is under the 1938 Maloney Act amendments to the Exchange Act to examine disciplinary action by a registered securities association (i.e. by the NASD) s 15A(g), 15(h), 25(a), 15 USC ss 78o-3(h), 78y(a); see R.H. Johnson & Co. v. Securities and Exchange Commission, 198 F.2d 690 (C.A. 2d Cir. 1952), cert. den. 344 U.S. 855, 97 L ed. 655, 73 C. Ct. 94, a different case would arise concerning exemption from the operation of laws designed to prevent anti-competitive activity, an issue we do not decide today.

and further, at page 360:

> Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12, supra.

Further, insofar as the doctrine of implied repeal is concerned, the Court in Silver held that when applied to the antitrust laws repeal would be implied only to the minimum extent necessary to resolve any conflict between the two statutes. The Fifth Circuit has misapplied this doctrine to

the express repeal provisions of Section (n) so as to limit the Association's authority under the Maloney Act in this language:

> To determine if they conflict, the Maloney Act should be construed to reach only those things necessary to carry out the purposes of the Act. (Appendix A-6) (Emphasis added)

The Maloney Act, however, is to the contrary. It specifically states that it "shall prevail" in event of conflict. (15 USC 78o-3(n)

There are numerous other factors which distinguish this case from Silver. Initially, there is a material and substantial distinction between the adoption and effectuation of the Association's rules (which must be acted upon by the SEC before they can become effective) and an Exchange's rules (which can become effective without SEC action). (See 15 USC 78o-3(b), (j) (the Association) and 15 USC 78l(a)(3)(4); 78f(c); 78s(b) and 17 CFR 240 17a-8 (the Exchange) for a comparison). The SEC has no authority to disapprove an Exchange's rules before effectiveness.

The Commission does, however, as stated in Thill Securities Corporation v. The New York Stock Exchange, 433 F.2d 204 (7th Cir. (1970)) have "limited authority" to "order changes in [existing] rules respecting a number of [but not all] subjects" after notice and opportunity for hearing (15 USC 78s-(b).

This is an extremely important distinction since the Court in Thill said the issue in that case related only to "potential review." The Exchange therein contended "potential review" by the SEC "freed its rulings from the antitrust laws." (433 F.2d at 267). The Court disagreed saying: (433 F.2d at 269)

> ... we find in the teachings of Silver, no intimation that the mere possibility of SEC review wraps the conduct of the Exchange in an impregnable shield of antitrust immunity. (Emphasis added)

and that: (433 F.2d at 271)

> ... there is no evidence in the record that the SEC is exercising actual and adequate review jurisdiction under the Act. (Emphasis added)

Actual and close supervision, not potential supervision, is not only the statutory requirement as to the Association's regulations, contrary to the potential after the fact review as to Exchange rules, but it has been demonstrated in the record of this case to have actually been exercised as to the adoption of the Interpretation here questioned. The Fifth Circuit itself recognized its error in this respect when in its opinion on the Association's Petition for Rehearing (wherein the Association forcefully argued the existence of actual and adequate supervision) it ordered deleted from its initial opinion the following language:

> The extent of that supervision is not readily apparent from the record. (Appendix B-2)

On the question of actual and adequate supervision by the Commission in this case, the record contains a copy of a minute order from the official records of the Commission reflecting affirmative action taken by it authorizing the Association to "proceed with the issuance and publication"of the Interpretation. (Appendix E-2) The order also instructs the Association to consider broadening the rule and to go even further than it proposed, i.e., make it apply to all other redeemable investment company shares as well as contractual plans. (Appendix E-2) This minute order, on its face, as well as the accompanying cover letter (Appendix E-1) manifestly demonstrates the close attention, consideration and study which the Commission gave to the Interpretation prior to authorizing its adoption.

Also part of the record is a deposition taken at the instance of the plaintiffs of Mr. James A. Ratzlaff, then Secretary of the Association's Investment Companies Committee, in which he testified as to the many meetings with the SEC staff and the names of the important, top staff personnel who were present. These were: (Ratzlaff Deposition, p. 19)

Solomon Friedman, Director of the Division of Corporate Regulation; 6/

John Dudley, then Associate Director of the Division of Corporate Regulation;

Robert Block, then Chief Counsel, Division of Trading and Markets; and 7/

Martin Moskowitz, then Special Counsel, Division of Trading and Markets.

These were not all of the Commission staff who participated. Mr. Ratzlaff said he "can't remember all the people." (Ratzlaff Deposition, p. 19). He also said these meetings took place "on a number of occasions" (Ratzlaff Deposition, p. 170) and that the SEC staff actually called the abuse to the Association's attention, apparently almost simultaneously with others (Ratzlaff Deposition, p. 8). Obviously, the abuse became so rampant and flagrant there was an outcry from within the industry and without that it be stopped. As the initial step in its supervisory oversight over the Association the Commission staff put the Association on notice to activate the regulatory machinery.

Mr. Ratzlaff testified that the Commission staff concurred with the Association that the privilege was being misused and abused. (Ratzlaff Deposition, p. 20)

Attached to Mr. Ratzlaff's deposition are a series of memoranda summarizing the meetings and drafting discussions with the SEC staff. (Ratzlaff Deposition lP. Ex.

6/ The Division of Corporate Regulation is that Division of the SEC charged with enforcement and regulatory activities in connection with the Investment Company Act of 1940 and thus is intimately involved in all regulatory matters involving mutual funds.

7/ The Division of Trading and Markets is that Division of the SEC with direct jurisdiction over the Association.

No. 5, two memoranda one of which contains details of the abuse and a summarization of the statistics relied upon in enacting the Interpretation; Pl. Ex. No. 13; Pl. Ex. No. 14, noting that the last paragraph was added at the Commission's request.)

The record also contains an affidavit from Mr. Ratzlaff which further documents meetings between the respective staffs. (Ex. No. 17 to Association's Motion). At no place in the record is there any evidence contradicting any of the above nor was any attempt made by plaintiffs to dispute it or to attack the credibility or accuracy of such. Even with the emergency character of the abuse, supervisory oversight by the Commission was extensive. As a result, the demonstrated abuse was stopped. This action -- in the public interest -- should be applauded rather than condemned by the court. Over 110,000 shareholders of Technology Fund (and those of another fund not party to this proceeding) benefited.

In considering the adequacy of the supervision exercised, it is also important to note that the Commission detailed its and the Association's efforts, the abuse which was being attacked, the effect thereof and the effect of the Interpretation on the abuse in an official report to the 89th Congress (Report of Securities and Exchange Commission on Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2nd Sess., 26-27, 304-305)

In Silver, there was no Commission review, or even the possibility of Commission review, whereas in this case not only was there review, but the Commission and its staff participated in the drafting of the Interpretation and the Commission approved the Interpretation. This is clear in the record and is not disputed. No reasons were given by the Exchange for its actions in Silver (reasons were refused after requested by plaintiffs), whereas here the reasons were clearly delineated in the Interpretation itself. No hearing was requested here, whereas a hearing was specifically refused after being requested in Silver. The Exchange's action in Silver was discriminatory since it applied only to plaintiff, whereas the Interpretation herein applies to all of the Association's members. No injury to the public was shown

in Silver, whereas it was clearly shown here by virtue of 1,258 programholders causing the dilution of the holdings of 110,000 other shareholders. The action by the Exchange in Silver took effect immediately whereas after the Interpretation herein was declared effective it was suspended (at Defendant Growth's request) for fourteen months to determine if, as argued by defendant Growth, the abuse would be curbed by "attrition" which did not occur; thereafter it was strictly enforced; no requests for a hearing were made by plaintiffs during this period. Section 15A(k)(1) of the Maloney Act (15 USC 78o-3(k)(1) provides a means for review of the Interpretation by the filing of a Petition with the Securities and Exchange Commission to abrogate such. This is not possible with respect to Exchange rules or rulings. The only method of enforcement of the Interpretation by the Association would be by disciplinary proceedings with right of hearing, representation by counsel and appeal to the Court of Appeals. These factors were alluded to in Silver but were not available to the plaintiffs in Silver.

4. The Securities and Exchange Commission Does Not Have to Make a Record Showing Antitrust Consideration of Proposed Rule

The Court of Appeals seems to say that the Commission must make a record as to its consideration of the antitrust effects of a rule proposed by the Association. It states:

> The Maloney Act explicitly provides that the Commission is to consider antitrust effect in connection with the rules of the national securities associations (15 USC 78o-3(b)(8). The record is barren of what consideration, if any, was given. (Appendix A-6)

The Maloney Act imposes no such requirement. The only requirement imposed upon the Commission in respect to its review of the Association's rules is that it determine whether the proposal is consistent with specifically designated provisions of the Maloney Act. The pertinent provision states as follows:

> Any change in or addition to the rules of a registered securities association shall take

effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (d) [of the Maloney Act]. (15 USC 78o-3(j)) (Emphasis added)

Subsection (b)(8) was cited by the Fifth Circuit as requiring the Commission to consider the antitrust effects of a proposed rule (presumedly calling into play the entire body of antitrust law) but that section, quoted above at page 5, does not so require though it does speak of discrimination and other things which perhaps relate to areas otherwise governed by the antitrust laws. But this does not mean the Commission must examine a rule from the standpoint of the vast body of complex antitrust law to determine if it is consistent with that section. If Congress wanted it to do that it would have said so.

Further, the Court's language quoted above appears to be contrary to this Court's statement in Silver that where there is supervision by a governmental agency a different case is presented, pointing to the Maloney Act as an example.

No authority supports a conclusion that an "antitrust record" must be made. Also, no standards or guidelines exist or have even been suggested as to what such a record should contain. If such a requirement remains, every action taken by every administrative agency would be subject to attack where such a record is absent. The making of an "antitrust record" has thus suddenly appeared in the field of administrative jurisprudence and administrative agencies will become bogged down in antitrust quicksand.

5. The Securities and Exchange Commission Has Primary Jurisdiction -- Plaintiffs Failed to Exhaust Their Administrative Remedies

In the Maloney Act, Congress specified the procedure

by which regulations of the Association should be challenged. That procedure is by way of a Petition to Abrogate filed with the Securities and Exchange Commission with the right of appeal to the appropriate United States Court of Appeals (15 USC 78o-3(k), 15 USC 78y). If disciplinary action were taken by the Association for violation of a rule, comparable procedures are provided in which a rule could also be challenged. (15 USC 78o-3(b)(9)-(10), (g) and (h); 15 USC 78y) Thus, the proper forum for plaintiffs if they desire to question the validity of the Interpretation in question is the Commission not the District Court. Plaintiffs have failed to follow the prescribed procedure and the District Court so noted. (Appendix C-5) Such action should have been taken at the time the rule was announced. It could have been taken during the fourteen-month hiatus period discussed above or even during the subsequent period. Plaintiffs chose instead to disregard the statutory procedures and to avoid the agency with expertise in the securities field which, it is submitted, is best able to evaluate the facts of this case subject, of course, to review by the United States Court of Appeals. The doctrines of failure to exhaust administrative remedies and primary jurisdiction of administrative agencies are well established in American jurisprudence. (Federal Communications Commission v. Schrecker, 381 US 279, 296-297 (1969); Reisman v. Caplan, 375 US 440 (1964); Myers v. Bethlehem Shipbuilding Corp., 301 US 41, 50-51 (1938); United States v. Philadelphia National Bank, et al, 347 US 321, 353 (1963) and cases cited therein; Philadelphia Co. v. Securities and Exchange Commission, 164 F.2d 889, 897 (D.C. Cir. 1948), cert. den. 333 US 828 (1948); Far Eastern Conference v. United States, 342 US 570, 574-575 (1952) and many others.) The principles of these cases should be applied to this case. The Court of Appeals refused to do so notwithstanding the Association's motion requesting such.

6. The Interpretation Is Not a New Rule

The Court in concluding that it was "not persuaded by the NASD argument that this [the Interpretation] is not a new rule, but merely an interpretation of an old rule, and therefore one that has been in effect for 26 years" (Appendix A-4) apparently questions the legality of interpretations of broad rules. There can be no question that the Association's Board of Governors has the authority to issue

interpretations pursuant to the Association's By-Laws quoted above at page 6 and it has consistently done so since 1939.

The rule interpreted, Article III, Section 1 of the Association's Rules of Fair Practice (quoted above at page 6), became effective in 1939 when the Commission determined it was consistent with the provisions of the Maloney Act. (5 SEC 627 (1939)) That rule laid down the general standard of conduct pursuant to which all of the Association's members must act. The Commission accepted the Interpretation here questioned as a proper application of that general standard. This procedure has been followed many times in the past, has been challenged and never overturned. (Handley Investment Company v. Securities and Exchange Commission, 354 F. 2d 65 (1965) wherein an Interpretation covering the Markup Policy was used to discipline a member; Samuel B. Franklin v. Securities and Exchange Commission, 290 F. 2d 719 (9th Cir. 1961) cert. den. 368 US 889. See also the following as illustrations of interpretations ruled upon by the Commission: Interpretation With Respect to "Free-Riding and Withholding," Rentz & Company, Inc., Sec. Ex. Act Rel. No. 8314 (1967); A. J. Gabriel & Co., Sec. Ex. Act Rel. No. 7696 (1965); Bailey & Co., Sec. Ex. Act Rel. No. 7241 (1964); Guardian Investment Corporation, Sec. Ex. Act. Rel. No. 7239 (1964); I. H. Rothschild & Co., Sec. Ex. Act Rel. No. 7182 (1963); First California Co., 40 SEC 768 (1961); Interpretation with Respect to Advertising Sales Literature and Recruiting of Sales Personnel; Valley Forge Securities Company, Inc., Sec. Ex. Act Rel. No. 7055 (1963); Interpretation Re: Markup Policy.

The Association could have attacked the improper use of the privilege on a case-by-case basis through disciplinary proceedings without notice to the membership on the basis of the practice being violative of Article III, Section 1 of the Rules of Fair Practice which, as stated, lays down the general ethical standard of conduct expected of members.

The Association chose, however, to give advance notice to its membership that the practice was improper and

this it did by publishing an Interpretation. In respect to the legality these alternative methods of regulating conduct violative of a general standard, the Commission has stated as follows in discussing the Markup Policy, also an interpretation of Section 1: (17 SEC 459, 470)

> True, the Board was under no duty to notify the membership of its decisional policies. It could take up trade practice cases one by one and in rendering its decision inform its members of what they might expect by way of pricing policies. Often the case by case method of making policy is necessary. Sometimes, on the other hand, advance notice can be given. The Board here determined that giving advance notice was a fairer method, and we see no reason for criticizing its determination or doubting its good faith.

On the same question, American Jurisprudence states as follows:

> An administrative agency exercising both legislative and adjudicatory powers may have a discretion to fulfill its functions by proceeding by establishment of a general rule or by individual ad hoc litigation. This discretion may be considered from the standpoint of whether the making of a rule is essential to the exercise of a power, for example, whether particular conduct must be condemned by rule before it can be made unlawful, or from the standpoint of whether an agency may adopt a general rule which predetermines a particular case. It appears an agency may adopt such a rule, particularly when it grows out of the experience of the agency . . . (2 Am. Jur., Administrative Law, § 299, p. 125) (Emphasis added)

The Supreme Court also has long ago accepted as valid the alternative procedure for implementing statutory standards:

> In other words, problems may arise in a case in which the administrative agency could not reasonably foresee, problems which must be solved despite the absence of a relevant general rule . . . There is thus a very definite place for a case-by-case evaluation of statutory standards. And the choice made between providing by general rule or by individual, ad hoc litigation is one that lies presumably in the informed discretion of the administrative agency. See Columbia Broadcasting System v. United States, 316 US 407, 421. (Securities and Exchange Commission v. Chenery Corp., 332 US 194 (1947) at 202-203)

Such is consistent with the general proposition of law that regulations cannot be expected to cover by specific and explicit language every possible situation of abuse. The Fifth Circuit by its conclusion that a new rule was adopted has disregarded the law on the subject. All the Association did was interpret an existing broad rule in such a way as to put an end to a new scheme which was detrimental to the public.

CONCLUSION

For the foregoing reasons, a Writ of Certiorari should issue to review the judgment and opinions of the United States Court of Appeals for the Fifth Circuit.

RESPECTFULLY SUBMITTED,

Lloyd J. Derrickson
Frank J. Wilson
1735 K Street, N. W.
Washington, D. C. 20006

Joel H. Pullen
DAVIS, O'CONNOR & PULLEN
1515 National Bank of Commerce Building
San Antonio, Texas 78205

COUNSEL FOR PETITIONER

PROOF OF SERVICE

I, Lloyd J. Derrickson, counsel for the National Association of Securities Dealers, Inc., petitioner herein, and a member of the Bar of the Supreme Court of the United States hereby certify that, on the 10th day of July, 1972, I served copies of the foregoing Petition for Writ of Certiorari to the Supreme Court of the United States on the several parties thereto as follows:

1. On Norman L. Harwell, et al, respondents, by mailing three copies in duly addressed envelopes, with air mail postage prepaid, to their attorneys of record as follows:

> To Teairl W. Lewis, Esq. and Clarence B. Boatwright, Esq., Attorneys for Norman L. Harwell, et al, at Lewis & Davis, 1215 National Bank of Commerce Building, San Antonio, Texas 78205.

2. On Growth Programs, Inc. and Supervised Investors Services, Inc., appellees below, by mailing three copies in duly addressed envelopes, with air mail postage prepaid, to their attorneys of record, as follows:

> To Lionel R. Fuller, Esq. and James D. Baskin, Jr., Esq., Attorneys for Growth Programs and Supervised Investors Services below, at Matthews, Nowlin, MacFarlane & Barrett, 1500 Alamo National Building, San Antonio, Texas 78205.

3. On the Securities and Exchange Commission, amicus curiae below, by mailing three copies, in a duly addressed envelope to G. Bradford Cook, Esq., its General Counsel, at the offices of the Commission, Washington, D.C. 20549.

It is further certified that all parties required to be served have been served.

Lloyd J. Derrickson
1735 K Street, N. W.
Washington, D. C. 20006

Supreme Court, U. S.
FILED
JUL 10 1972
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

NO. _____

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
Petitioner

v.

NORMAN L. HARWELL, et al

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

COPY BOUN

Norman L. HARWELL, et al., Plaintiffs-Appellants,

v.

GROWTH PROGRAMS, INC., et al., Defendants-Appellees.

No. 30501.

United States Court of Appeals, Fifth Circuit.

Oct. 15, 1971.

Rehearing and Rehearing En Banc Denied April 11, 1972.

Teairl W. Lewis, Clarence R. Boatwright, San Antonio, Tex., Fiorenzo V. Lopardo, Robert A. Hefner, Escondido, Cal., Benjamin H. Dorsey, Washington, D. C., for plaintiffs-appellants.

James D. Baskin, Jr., Lionel R. Fuller, Joel H. Pullen, San Antonio, Tex., Frank J. Wilson, Washington, D. C., for defendants-appellees.

Paul Gonson, Asst. Gen. Counsel, Kathryn B. McGrath, Warren G. Stolusky, Attys., Philip A. Loomis, Jr., Gen. Counsel, David Ferber, Sol. S. E. C., Washington, D. C., amicus curiae, for defendants-appellees.

Before COLEMAN, SIMPSON and RONEY, Circuit Judges.

RONEY, Circuit Judge:

This is an appeal from a summary judgment against holders of single investment mutual fund programs who sought relief from the failure of the sponsor of such programs to comply with that portion of their investment contracts which permitted the holders to move in and out of an investment position in the fund, without the payment of brokerage commissions, on an unlimited basis. The sponsor refused to comply with this unlimited privilege in the investment contract because the National Association of Securities Dealers (NASD) issued an Interpretation of its rules which made it improper for it members to be involved with the unlimited manner in which the "in-and-out" privilege was being used.

The district court by summary judgment held that the Association had authority to promulgate an "interpretation" of its rules limiting the "in-and-out" privilege even in existing contracts providing unlimited privilege, that the purchasers were not denied due process, that they were not entitled to damages for breach of contract, and that the NASD was immune from antitrust liability. Harwell v. Growth Programs, Inc., 315 F.Supp. 1184 (W.D.Tex.1970).

We reverse and remand on the ground that this case was not disposed of properly by summary judgment. There are difficult issues which can be determined only after a trial on the merits.

The parties tell us that this case presents questions of first impression which will establish important precedents in the field of securities law. It is not our intention by this decision to make any final determination of those questions. It seems inappropriate to try to determine the precise rules which should be applied until the case has been heard on the merits, the facts have been fully developed and the trial judge has made the difficult reconciliations required on the evidence presented.

To that end we review the matter briefly so that the trial court will know the problems we foresee that it will have to confront and solve before rendering a final decision in this case.

The Parties.

Originally a defendant but dropped by stipulation, Technology Fund, Inc., is an open-end investment company commonly referred to as a mutual fund, which invests the money it receives from the sale of its common shares in securities of other companies. As an open-end investment company, it continuously offers its shares for sale to the public and stands ready at any time to repurchase any of its outstanding shares when presented to it by a shareholder.

Defendant Supervised Investors Serv-

OUND CLOSE IN CENTER

ices, Inc. separately owned and operated from the Fund, is the management company for the Fund, is the principal underwriter for the sale of the Fund's shares, is a registered broker-dealer under Section 15 of the Securities Exchange Act of 1934, and is a member of the NASD.

The principal method of offering the Fund's shares is through wholesale sales by Supervised to broker-dealers, who in turn sell them retail to the public. In addition, the shares of the Fund are offered through what are known as "contractual plans."

Defendant Growth Programs, Inc. sells the contractual plans. This involves the sale of a plan certificate which evidences a beneficial interest in the shares of the mutual fund. The holder may redeem his certificate for the cash value of the underlying shares, or, at his option, may receive the shares themselves. Growth is a subsidiary corporation of Supervised and a registered broker-dealer under the Securities Exchange Act and a member of the NASD.

The plaintiffs represent as a class persons who have purchased contractual plans from Growth.

The Investment Contract.

The plans held by plaintiffs are what are known as single investment plans, for which the holders paid a single lump sum of money. The plan is registered with the Securities Exchange Commission under the Securities Act of 1933.

The withdrawal and reinstatement privilege set forth in the programs, the so-called "in-and-out" privilege, provides that a programholder can withdraw and convert into cash, from time to time, up to 90% of the Fund shares underlying his plan and thereafter reinvest the same amount of cash in shares of the Fund without the payment of a further sales charge. Instructions for withdrawal and reinstatement can be made by telephone or wire through a broker-dealer representing the programholder, and the price at which such withdrawals and reinstatements are to be effected is the net asset value of the underlying Fund shares at the time the telephone or wire instructions are received.

The NASD "Interpretation".

In July, 1966, after all of the plaintiffs had purchased their contracts, the National Association of Securities Dealers published an "Interpretation With Respect to Contractual Plan Withdrawal and Reinstatement Privileges" by which it sought to interpret the following Section 1 of Article III of the Rules of Fair Practice, which were adopted in 1939 by the NASD:

> "A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."

By its Interpretation, the NASD in effect made it a violation of this Rule of Fair Practice for any of its members to suggest, encourage or assist any planholder in the unlimited exercise of the "in-and-out" privilege, placing severe limits on the reasons for, and the frequency of, withdrawal and reinstatement.[1] The penalty suffered by a broker-dealer member who violates the Rules of the NASD could be such as to put him out of the securities dealer business. After the Interpretation was

1. Although withdrawal and reinvestment clauses have been included in investment plan contracts since 1930 for the declared purpose of protecting investors against temporary financial emergencies, it was not until 1965 that Growth devised a contract designed to facilitate the use of the privilege by establishing a procedure for telephone and wire orders, use of power of attorney to execute the privilege, and establishment of credit at a bank which eliminated the need for transfer of funds. These procedures were not all written into the contract, but they, together with the pricing method then being used which generally guaranteed success on the exercise of the privilege (see fn. 2), permitted the use of the privilege for speculating on short swings of the market. This resulted in massive withdrawals and reinvestments, often on the same day, and an alleged dilution in the inter-

COPY BOUND

...ssed, the plaintiffs were effectively foreclosed from exercising the privilege as provided in the contract because no broker-dealer could execute their orders in the same manner as before.

The Arguments.

The plaintiffs claim that there is an admitted breach of contract for which they are entitled to an injunction, specific performance and damages. In addition they assert that the NASD had no authority to promulgate the Interpretation and therefore is liable for damages for tortious interference with plaintiffs' contracts and that the defendants are liable for damages for violation of the antitrust laws.

Growth and Supervised argue that the NASD Interpretation resulted from a valid exercise of the authority granted the NASD by the Maloney Act, that they cannot be held liable for breaching the plaintiffs' contracts where the breach resulted from their required compliance with the Interpretation, that the NASD and its members are immune from antitrust action because the NASD is acting in a quasi-governmental capacity under the Maloney Act under close supervision of the SEC, that the class plaintiffs who are also members of NASD are estopped from asserting a cause of action against Growth and Supervised, and further argue that Growth is not merely the alter ego of Supervised and that the district court erred only in its holding that Supervised could be held liable in the event Growth should be liable.

The NASD argues that any interference with plaintiffs' contracts was not wrongful because it was properly exercising its delegated authority pursuant to the Maloney Act, that its Interpretation was valid and that it was not retroactive because it merely interpreted a Rule which had been in effect for approximately 26 years, that plaintiffs showed no violation of the antitrust laws and that in any event the antitrust laws do not apply to this situation, and that there was no constitutional infirmity in the Association's actions. It disclaims any position as to liability of Growth Programs or Supervised Investors to the plaintiffs for breach of contract.

The Securities and Exchange Commission has filed an amicus curiae brief in which it defends the NASD Interpretation as being clearly within its power under the Maloney Act and not promulgated in violation of due process of law, and argues that the issuance of the Interpretation of existing Rules of Fair Practice by NASD, with SEC concurrence, did not constitute a violation of the antitrust laws. It, too, took no position as to the liability of Growth Programs or Supervised Investors to plaintiffs on the breach of contract action.

The Issues.

[1, 2] We agree with the district court that "the path to a correct decision is lined with deep-rooted public policy considerations" and that this "is not simply a garden variety breach of contract action." Plaintiffs' apparent refusal to recognize this fact undoubtedly beclouds the issues and may very well ultimately be fatal to their case. They must in the end carry the burden of showing the exact relief to which they are entitled, if any, taking into full consideration the public interest that the Commission and the NASD have been charged by Congress to protect. Governmental regulation of the securities market is too much a part of today's life to provide much validity to the broad attacks which the plaintiffs make on the authority of the SEC and the NASD. Anyone dealing in securities today must be charged with the knowledge that they are operating in a closely regulated field in which the public interest and public policy play a dominant part.

[3] Notwithstanding this, however, the lower court must determine from the evidence and the facts whether or not the retroactive effect of the NASD In-

...other 110,000 shareholders. There ...1398 shareholders in plaintiffs' class. It was this activity which motivated the action of the NASD.

ND CLOSE IN CENTER

terpretation was necessary to protect that public interest. A reasonable rule for prospective conduct could well be unreasonable when applied retrospectively. We are not persuaded by the NASD argument that this is not a new rule, but merely an interpretation of an old rule, and therefore one that has been in effect for 26 years. There appears little doubt that this Interpretation was aimed directly at Growth and these plaintiffs, and another fund that had developed a similar type of contract. The case has to be dealt with on these terms.

In addition to the extent to which the public interest required retroactive application of the Interpretation, there are distinct issues of fact which are relevant and must be given full consideration: whether SEC or NASD approved the unlimited "in-and-out" privilege; whether plaintiffs' activities constituted an "abuse" of their privilege or did in fact violate the provisions of their contracts; whether due process was afforded to these parties administratively; whether Growth itself was involved in the development of the Interpretation; and whether Growth made representations on the sale of these investment contracts and encouraged the use of the privilege.

It is noted that NASD has argued that the case is largely, if not completely, moot because a key ingredient in the successful exercise of the privilege was the method of computation of price. This has now been changed by action of the NASD, the SEC, and the custodian bank of Technology Fund, Inc., the underlying mutual fund of Growth. The facts concerning this argument must be considered in determining whether it was the privilege itself which was contrary to public interest, or the pricing method by which it could be used. Plaintiffs had no contractual right to the pricing method.[2]

[4–6] It is generally conceded that Growth breached its contracts with the plaintiffs. After an examination of all of the facts, the court can determine whether Growth might be liable for damages, even if the court should determine that the contracts cannot be specifically enforced. The parties to a contract rendered impossible to perform by government regulation are not always excluded from the exposure to liability. The NASD Interpretation does not make the contract illegal but only makes it improper for the NASD members to be involved with it. There is a distinction between a literal impossibility of performance and mere economic inadvisability. See Haby v. Stanolind Oil and Gas Co., 228 F.2d 298 (5th Cir. 1955). The representations Growth made on the sale of the contracts to plaintiffs, the extent to which Growth was involved in the administrative process, the extent to which it could have preserved the possibility of performance, the extent to which it encouraged the plaintiffs' so-called "abuse" of the "in-and-out" privilege are all facts which must first be determined before a decision can be made as to whether any remedy is available to plaintiffs for the admitted breach of their contracts.

We should comment on the antitrust aspect of the decision of the court below. To do this we will assume, without deciding, that the actions of the defendants alleged in the complaint would constitute a violation of the antitrust laws

2. Under the prior price system, the net asset value of the mutual fund shares was computed twice per day, as of 1:00 P.M. to become effective at 2:00 P.M. and as of 3:30 P.M. to become effective at 4:30 P.M. Thus a broker had an hour within which to compute or otherwise ascertain the next price: Plaintiffs could withdraw and reinvest with absolute certainty that a lower next price would give them an increased number of shares. The NASD brief states that as a result of this:

> "They could not suffer a loss because they knew the next price and compared it with the previous price, which previous price would be applicable to the withdrawal. The next price would apply to reinvestment. The net effect of this was that the plaintiffs could do what every investor wishes he could do, that is, know the future value of his investment before he buys."

COPY BOUND CL

ad they occurred in the ordinary course of commerce.[3] The question is whether the defendants can escape the application of those laws to their activity. The defendants argue that their conduct was authorized by the Maloney Act and cloaked with specific Congressional immunity by virtue of 15 U.S.C. § 78o-3(n) which provides:

"(n) If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail."

There has been no authoritative decision on the extent to which this section gives the NASD and its members antitrust immunity. It has been indicated on numerous occasions that this section was intended by Congress to lift the ban of antitrust laws against conduct of the NASD pursuant to § 78o-3.[4]

[7] This section, by its terms, grants no specific antitrust immunity. However, it seems clear that if conduct is permitted, authorized or required by this Act, Congress intended that such action would not be prohibited by any law in force on June 25, 1938, including the antitrust law. But it does not follow that NASD and its members are immune from antitrust attack in *all* of their activities, and neither the NASD nor the SEC so argue. The question is whether there is immunity in the making of this Interpretation.

[8] The NASD is authorized, even required, by the Act to promulgate rules designed to promote just and equitable principles of trade and to protect investors and the public interest.[5] The court must determine when the NASD is immune from antitrust penalty in acting in its rule making capacity. It appears to us that by judicial interpretation Silver v. New York Stock Exchange, 373 U.S. 341, 83 S.Ct. 1246, 10 L.Ed.2d 389 (1962) has added to the Act regulating

3. We agree with the district court that these allegations are vague, and may lack merit, but the court did not consider the claim on the merits.

4. United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) [fn. 60 in Justice Douglas' opinion, p. 227], 60 S.Ct. 811, 84 L.Ed. 1129; International Ass'n of Machinists v. Street, 367 U.S. 740 (1961) [fn. 16 in Justice Frankfurter's dissenting opinion, p. 809], 81 S.Ct. 1784, 6 L.Ed.2d 1141; United States v. Morgan, 118 F.Supp. 621 (S.D.N.Y.1953) ["By express statutory provision, Securities Exchange Act of 1934, Section 15A(n), the Rules of Fair Practice of the NASD are, when approved by the SEC, exempt from the application of the antitrust laws, if in conflict. This is not disputed." Judge Medina's opinion, p. 693]; Silver v. New York Stock Exchange, 302 F.2d 714 (2 Cir., 1962), rev'd 373 U.S. 341, 83 S.Ct. 1246, 10 L.Ed.2d 389 (1962) ["In other provisions of the Securities Exchange Act, namely those sections governing over-the-counter brokers' and dealers' associations, 52 Stat. 1070 (1938), 15 U.S.C.A. § 78o-3, the draftsmen of our securities statutes provided an explicit exemption from the anti-trust laws. 15 U.S.C.A. § 78o-3(n)." Judge Waterman's dissenting opinion, p. 722]; Silver v. New York Stock Exchange, 196 F.Supp. 209 (S.D. N.Y.1961). ["Moreover, in the 1938 amendment Congress expressly provided that in the event of conflict between any provisions of the 1938 Act and any other provisions of law, the provisions of the 1938 Act should prevail. 15 U.S.C.A. § 78o-3(n). This, of course, includes the anti-trust laws." Judge Bryan's opinion, p. 220]; See Loss on Security Regulations, Vol. II, Chapter 8C3 "The Maloney Act and the Anti-Trust Laws," p. 1369.

5. 15 U.S.C. § 78o-3(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

(8) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits; to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

CLOSE IN CENTER

Securities Exchanges, the same Congressional intent explicitly set forth in the Act regulating brokers' and dealers' associations. Implicit in the judgment of the whole court in *Silver*, majority, concurring and dissenting, is the basic concept that the Securities Act prevails over the antitrust acts, when the provisions of the two are in conflict. It seems to us that § 78*o*–3(n) provides no more. *Silver* then furnishes the guide which must be followed, i.e., that the repeal of the antitrust barrier to defendants' actions occurs only if those actions are necessary to make the statutory scheme for regulation of securities dealers work, and then only to the minimum extent necessary. In other words, the Maloney Act "prevails" over any other laws of the United States only to the extent that they conflict. To determine if they conflict, the Maloney Act should be construed to reach only those things necessary to carry out the purposes of the Act.

[9] This should be the thrust of the further proceedings in this case, insofar as it relates to the antitrust claim. It is argued with some force that this case is different than *Silver* because here the NASD acted under close supervision of the SEC. The extent of that supervision is not readily apparent from the record. In any event this argument, as applied to the New York Stock Exchange, was rejected in Thill Securities Corporation v. New York Stock Exchange, 433 F.2d 264 (7th Cir. 1970) and it would seem that it should be rejected here for the reasons set forth in that multiple opinion case.

The Maloney Act explicity provides that the Commission is to consider antitrust effect in connection with the rules of the national securities association. 15 U.S.C. § 78*o*–3(b) (8). The record is barren of what consideration, if any, was given.

The decisions concerning the exhaustion of administrative remedies, the effect of the litigation in which shareholders sued the Fund for damages because of the misuse of the "in-and-out" privilege, Lessac v. Television-Electronics Fund and Stuart v. Tripp, CCH Fed. Sec.L.Rep. § 92,305 (S.D.N.Y.1968) and the question as to whether Growth was the alter ego of Supervised are all open for reconsideration by the court upon remand.

Reversal.

On all of these matters we simply hold that the lower court decided too much on broad principles that may or may not be applicable when the final determination is made of all of the detailed issues which must be reconciled in a case of this kind.

Reversed and remanded.

COPY BC

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 30501

NORMAN L. HARWELL, ET AL,
Plaintiffs-Appellants,

versus

GROWTH PROGRAM, INC., ET AL.,
Defendants-Appellees.

Appeal from the United States District Court for the Western District of Texas

ON PETITIONS FOR REHEARING AND PETITIONS FOR REHEARING EN BANC

(Opinion Oct. 15, 1971, 5 Cir., 1971, ____ F.2d ____).

(April 11, 1972)

Before COLEMAN, SIMPSON and RONEY, Circuit Judges.

PER CURIAM: The opinion of the Court, dated October 15, 1971, is modified by deleting therefrom the last sentence on the last line of page 13 of the slip

BOUND CLOSE IN CENTER

opinion.[1] If on remand the proof should show that defendants have taken actions which violate the antitrust laws, and if, in accordance with the principles of *Silver v. New York Stock Exchange*, 373 U.S. 341 (1962), the district court should find that the purposes of the Maloney Act do not require that these actions be cloaked with antitrust immunity, then the mere supervisory presence of the SEC cannot divest the courts of their power to enforce the antitrust laws. *Thill Securities Corporation v. The New York Stock Exchange*, 433 F.2d 264 (7th Cir. 1970).

We reemphasize that our decision is not intended to suggest the ultimate determination of the facts in this case or to intimate any opinion on the merits of plaintiffs' antitrust claim. Those determinations are for the district court.

The Petitions for Rehearing are DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the Petitions for Rehearing En Banc are DENIED.

---

[1] "The extent of that supervision is not readily apparent from the record."

Adm. Office, U.S. Courts—Scofields' Quality Printers, Inc., N. O., La.

Norman C. HARWELL et al.
v.
GROWTH PROGRAMS, INC., et al.
No. SA-66-CA-92.

United States District Court,
W. D. Texas,
San Antonio Division.
June 8, 1970.

Teairl W. Lewis, San Antonio, Tex., for plaintiffs.

Lionel R. Fuller, Joel H. Pullen, San Antonio, Tex., for defendants.

MEMORANDUM OPINION

ROBERTS, District Judge.

This class action was instituted on September 16, 1966, by the named plaintiffs complaining of a simple breach of contract by Defendants Growth Programs, Inc., (Growth) Supervised Investors Inc., (Supervised) and two other defendants who were subsequently dropped by stipulation.[1] The scope of the lawsuit was expanded on December 8, 1967, when the Plaintiffs' class, which had originally been confined to residents of San Antonio, Texas, was re-defined as "all persons holding single investment programs issued by Growth Programs, Inc.", and then again in September, 1968, when the National Association of Securities Dealers (NASD) was made a party defendant. On June 30, 1969, after Plaintiffs and Defendants had filed cross-motions for summary judgment, the Securities and Exchange Commission filed an amicus curiae brief with leave of this Court. Oral argument and briefing were concluded on April 2, 1970.

The Plaintiffs were all purchasers of a 30-year single investment program sponsored by Defendant Growth for purchases of shares of Television Electronics Fund, Inc. (now known as Technology Fund, Inc.).[2] All the investment contracts involved in this litigation contained provisions whereby the investor had the right to liquidate into cash at any time and from time to time without limit, up to 90% of his shares of the underlying mutual fund (Technology Fund, Inc.), and later, at any time, could repurchase shares in his account with the cash proceeds of his prior withdrawal, at the then present value of the shares, without the payment of any additional brokerage commission. This "withdrawal and reinvestment" privilege lies at the heart of this case.

Withdrawal and reinvestment clauses similar to the one involved in this case apparently have been routinely included in investment plan contracts since the 1930's. Such clauses were originally created as a means for protecting investments in single investment programs in situations where an investor was confronted with a serious, but temporary financial emergency. Before such in-and-out provisions were inserted in investment contracts, modest investors usually could not afford to liquidate and reinvest because 50% of the total brokerage fee on a long-term contract was taken out of the first year's investment, and in order to recoup the heavy front-end sales commission, investors had to leave their money in the program uninterrupted for a number of years.

From their inception up until 1965, the withdrawal-reinvestment privileges apparently were exercised sparingly by single investment planholders. In 1965, however, Defendant Growth and some of the larger class plaintiffs devised an investment contract designed to facilitate use of the withdrawal-reinvestment privilege as a tool for speculating on short swings in the market rather than merely for conserving the underlying investment during a personal financial crisis. For this purpose, Growth "streamlined" the usual withdrawal-reinvestment clause by specifying that the privilege could be exercised an unlimited number of times, and in-

1. Television-Electronics Fund, Inc. (now known as Technology Fund, Inc.), and [illegible] National Bank of Jersey City.

2. Defendant Supervised is the investment manager and underwriter for the Technology Fund, Inc.

stantly, either way, by use of the telephone or telegraph. Although the Growth Programs Prospectus contained a statement that "this is a long term investment program, not designed for a quick profit," the Growth Program sales brochures gave prominent play to the "unlimited 'IN-AND-OUT' privileges" and stressed that the investor could withdraw 90% of the market value of his shares "at any time" and then "reinvest the same amount of cash in shares of the Fund at net asset value, without sales commission."

Between May, 1965, and mid-January, 1966, the 1,258 class plaintiffs in this lawsuit bought the Growth Programs plan with the unlimited, instant "in-and-out" privilege.

Starting in June, 1965, many of the plaintiffs began using the in-and-out privilege for speculative purposes; namely, to play short swings of the stock market by withdrawing 90% of their funds with one phone call when they believed a downturn in the market was imminent, and then reinvesting with another call at the point believed to be the bottom of the downturn. Some groups of plaintiffs even went so far as to execute powers of attorney to their brokers who in turn could then withdraw or reinvest hundreds of thousands of dollars worth of the Fund with a single phone call. Such massive withdrawals and reinvestments were often effected on the same day, taking advantage of fractional swings in the market.

By early 1966, not only Defendant NASD, but also the Securities and Exchange Commission and the Association of Mutual Fund Plan Sponsors, Inc., had become concerned over this "abuse" and "prostitution" of the traditional withdrawal-reinvestment privilege; indeed, Defendant Growth itself made efforts to restrict the use of the privilege for speculative purposes by purchasers of its investment contracts after January 17, 1966, at which time Growth added a sticker to its prospectuses advising purchasers that Growth reserved the right to limit the exercise of the in-and-out privilege to four times per year.

Both the NASD and the SEC decided that this speculative activity, which often involved turn overs of millions of dollars a month in the Growth Program contracts alone, was harmful to the interests of both the "innocent" (non-speculating) shareholders in the underlying mutual funds, since it "diluted" their shares, and to the mutual funds themselves. On July 22, 1966, Defendant NASD, after extensive consultation with and the express approval of the Securities Exchange Commission, issued its "Interpretation with Respect to Contractual Plan Withdrawal and Reinstatement Privileges" which precipitated this lawsuit. The effect of the interpretation was to declare shortswing speculation in single investment programs to be not in the public interest, and to make it impossible for an NASD-member securities dealer to offer a long-term single investment program in which the withdrawal and reinvestment provision could be used for speculative purposes.

Since Growth Programs is a member of Defendant NASD, and is bound by its rules and regulations, Growth reluctantly, and after a wait-and-see delay of over one year, complied with the NASD interpretation and thereby violated its contracts with the Plaintiffs.

Plaintiffs seek a declaration that their contracts are valid and ask this Court for a decree granting them specific performance of the contracts and enjoining Defendants Growth and Supervised from further breach of the contracts; Plaintiffs also ask for actual and exemplary damages for Defendant NASD's unlawful interference with the performance of the contracts and request an injunction forbidding enforcement of the interpretation as it applies to them. In addition, Plaintiffs seek treble damages from all the Defendants for a conspiracy in violation of the anti-trust laws. Finally, Plaintiffs pray for Court costs and attorney's fees.

Both Plaintiffs and all De-

COPY BOUND CU

have filed cross-motions for summary judgment on the facts as set out above.

I.

Throughout the long course of this lawsuit the Plaintiffs have invited this Court to take an extremely narrow view of the issues to be decided in this case: their contracts have been breached—a fact that no Defendant denies—and since they have no adequate remedy at law (the damages are too speculative) they are entitled to specific performance and injunctions against all the Defendants. As even the most casual reader of the facts underlying the suit can tell, however, this is not simply a garden variety breach of contract suit and the Defendants have refused to so treat it. Defendants have stressed the proposition that this case cannot be considered in a vacuum, and that the path to a correct decision is lined with deep-rooted public policy considerations set out by Congress primarily in the Maloney Act. Plaintiffs counter that while "the history and economics of the Securities Industry in the United States" might make for "beneficial reading in a university course," the history and the policy behind the securities regulations "are merely academic, redundant, and have no bearing upon, nor are they germane to any issue before the Court."

To the extent that the Plaintiffs do recognize existence of large public policy issues involved in this lawsuit, they urge this Court to resolve these issues by resorting to "bedrock fundamentals," and in particular, to one such fundamental; namely that "substantive vested property rights" cannot be abridged, "not even [by] the Congress of the United States, much less [the] SEC or [the] NASD * * *" For the reasons set out below, we must reject the Plaintiffs' arguments and grant Defendants' motions for summary judgment.

II.

Plaintiffs have argued that Defendant NASD is just an ordinary non-profit [illegible] incorporated under the laws of Delaware. We do not agree. Section 15A of the Securities Exchange Act of 1934, (the Maloney Act of 1938), 15 U.S.C. § 78o–3(a)–(n) (1964) was passed in order to establish "a mechanism of regulation among over-the-counter brokers and dealers * * * to prevent acts and practices inconsistent with just and equitable principles of trade * * *." The Act authorizes the creation of one or more "national securities associations" to be registered with the Securities Exchange Commission. 15 U.S.C. § 78o–3(a) (1964); L. Loss, Securities Regulation 1361 (2d ed. 1961).

Before an association may be so registered, it must satisfy the Commission that it has met a number of standards set out in the Act. See generally 15 U.S.C. § 78o–3(b) (1964). For example, the association must have rules "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade * * * and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market * * *." 15 U.S.C. § 78o–3(b) (8) (1964). Moreover, the rules of the association must provide "that its members and persons associated with its members shall be appropriately disciplined by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules." 15 U.S.C. § 78o–3(b) (9) (1964).

After an association has been registered with the Commission, the Act gives the Commission broad powers of review over virtually every phase of the association's activity. The Commission can veto the promulgation of any new rule or amendment to an old rule proposed by the association if the Commission finds the proposed rule inconsistent with the Act, 15 U.S.C. § 78o–3(j) (1964); moreover, the Commission has the power to abrogate any association rule if it finds that abolishing the rule

D CLOSE IN CENTER

would effectuate the purposes of the Act, 15 U.S.C. § 78o–3(k) (1) (1964); and indeed, with respect to some matters, the Commission can effectively command the association to adopt a specific rule, 15 U.S.C. § 78o–3(k) (2) (1964). Finally, the Commission has plenary review powers over any disciplinary action taken by the association. 15 U.S.C. § 78o–3(g) (h) (1964).

[1] Far from being just an ordinary corporation, The National Association of Securities Dealers, although organized as a Delaware non-profit corporation, is the only "national securities association" registered under the Maloney Act: it is thus effectively a Congressionally-created regulatory organization governing conduct in the over-the-counter securities market.

[2] The Court has difficulty understanding Plaintiffs' unsupported contention that "even a regulatory body is without power or authority to determine public policy." It is of course hornbook law that Congress can—and often does—permissibly delegate "public policy determination" to an administrative agency. It is quite clear that the Maloney Act empowered the NASD to act—subject to pervasive supervision by the SEC—as a quasi-governmental agency charged with the responsibility of promoting, and enforcing, "just and equitable principles of trade" in the over-the-counter markets. This Congressional delegation of policy-making power to the NASD has been upheld in both R. H. Johnson & Co. v. S.E.C., 198 F.2d 690 (2nd Cir. 1952), cert. denied 344 U.S. 855, 73 S.Ct. 94, 97 L.Ed. 664 (1952) and in Nassau Securities Service v. S.E.C., 348 F.2d 133 (2nd Cir. 1965).

[3] Similarly, the Court is mystified by Plaintiffs' unsupported claims that the NASD "is no more than a disciplinary handmaiden to SEC;" (ironically, by making this argument Plaintiffs implicitly recognize that the NASD is a quasi-governmental agency) and that "under the Maloney Act, which is the only law giving it any authority, NASD has only the power to discipline membership." These assertions are demonstrably incorrect. See, e. g., 15 U.S.C. § 78o–3(j) (1964), which clearly contemplates rule-making activity on the part of a national securities association.

[4] While it may be true that greater attention to detail has been paid in the Act to procedural regularity in the NASD's performance of its adjudicatory functions, it does not therefore follow that issuance of an "interpretation" is not a legitimate exercise of the NASD's rule-making authority. The NASD's by-laws clearly legitimize "interpretation" as one form of rule-making, and SEC has on numerous occasions treated the NASD interpretations as rules for purposes of exercising its statutory power of review over NASD "rules". 15 U.S.C. § 78o–3(k) (1); see e. g., National Association of Securities Dealers, Inc., 17 S.E.C. 459 (1944) where the SEC upheld the NASD's "5 per cent markup policy," which was announced at least in part in an "interpretation" of the very NASD Rule of Fair Practice involved in this case. See also Handley Investment Co. v. SEC, 354 F.2d 64 (10th Cir. 1965).

[5] Plaintiffs' further contention that the NASD's decision to interpret the old fair practice rule rather than to attack the abuse of the in-and-out privilege on a case-by-case, disciplinary proceeding basis was a violation of due process of law is also clearly without merit. See, e. g., Columbia Broadcasting System v. United States, 316 U.S. 407, 421, 62 S.Ct. 1194, 86 L.Ed. 1563 (1942).

III.

In 1939, the SEC officially approved all of the NASD's Rules of Fair Practice. 5 SEC 627 (1939). Section 1 of Article III of those rules provides that "A member [of NASD], in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." It is this general standard of conduct

COPY BOUND CL

POOR COPY

interpreted by the NASD on July 22, 1966, in such a way as to "stop misuse of the withdrawal and reinstatement privilege extended to investors under certain methods of acquiring mutual fund shares." This interpretation, by its terms, applied to all investment plans, "regardless of when the plans involved were originally opened."

Plaintiffs have mounted a three-pronged attack on the interpretation. They argue that (1) the promulgation of the interpretation without a full-blown rulemaking hearing was a violation of due process of law; (2) the promulgation of the interpretation was unwise, and has no basis in fact; and (3) the retroactive application of the interpretation is a violation of due process of law.

There is no doubt that the procedures followed by the NASD in promulgating its interpretations leave a great deal to be desired, certainly when compared to the rule-making regimen set out in section 4 of the Administrative Procedure Act, 5 U.S.C. § 553 (1964). In this case, for example, no notice or chance for comment was given the NASD membership before the "legislative" rule in question here was handed down. Plaintiffs, however, have not pitched their complaints in terms of the process due to them under the APA—perhaps because they concluded that they could not, 5 U.S.C. § 551(1) (E) (1964)—but rather in terms of that process due them under the Constitution.

[6] We hold there is no constitutional infirmity in the interpretation proceedings to date. Indeed, it seems curious that Plaintiffs should complain to this Court that they have been denied due process when the truth of the matter is they have willfully bypassed the bulk of the "process" made available to them by the Maloney Act itself. For 15 U.S.C. § 78o-3(k) (1) clearly contemplates extensive SEC review of any rule—or interpretation, see, e. g., 17 SEC 459 (1944)—promulgated by the NASD: the Commission, "after appropriate notice and opportunity for hearing," can "abrogate" rule" if "such abrogation is ... appropriate to assure fair dealing by the members of * * * [NASD] * * *." Plaintiffs suggest no reason why they have not resorted to this expedient in this case.

[7] While as a general rule, this Court would deny Plaintiffs any consideration until their administrative remedies had been exhausted, there are several extenuating circumstances in this case that make that course of action unnecessary. In the first place, Plaintiffs seemingly do not have administrative review as of right in cases involving NASD rulemaking activity—unlike NASD disciplinary action, see 15 U.S.C. 778o-3(g) & (h) 1964—and thus it is not at all clear that treating this interpretation as final for purposes of review will disrupt a clearly established administrative scheme. Moreover, since a far narrower scope of review can be accorded the challenged rule by this Court than could be by the SEC in an abrogation proceeding, it is highly unlikely that many Plaintiffs will choose to ignore the chance of having an SEC hearing like these Plaintiffs apparently have.

Perhaps more importantly, the rationale for requiring exhaustion is very weak in this case since the SEC, the expert agency charged with supervising the NASD, has specifically approved adoption of the questioned rule in a meeting of the Commission itself, and has reiterated that approval both in an official report to Congress, Committee on Interstate and Foreign Commerce, Report of the SEC on the Public Policy Implications of Investment Company Growth, H.R.Rep. No. 2337, 89th Cong., 2d Sess. 26–27 (1966), and in an amicus brief filed with this Court. This Court has certainly not been deprived of "the benefit of the expertise of the federal agency which is primarily concerned with these problems." Rosado v. Wyman, 397 U.S. 397, 90 S.Ct. 1207, 25 L.Ed.2d 442 (1970).[3]

3. The Court cannot agree with the NASD's suggestion that the "exhaustion" and "primary jurisdiction" doctrines are so deeply rooted in American jurisprudence that they conspire to deprive this Court of jurisdiction in this case, even though the

D CLOSE IN CENTER

[8] On the basis of the voluminous record in this proceeding, we hold that the NASD interpretation questioned by the Plaintiffs is clearly within the power granted the NASD by the Maloney Act; that it was issued pursuant to proper procedure; and that it is reasonable. That is all this Court need decide.

[9] The Plaintiffs' final and most strenuously urged attack on the interpretation is that its retroactive application abridges their "substantive vested property rights." This Court had thought the power of "substantive vested property rights" as a talisman before which all other societal interests must fall had been put to rest over sixty years ago when, in response to just such an assertion, Justice Holmes made his famous remark that

> All rights tend to declare themselves absolute to their logical extreme. Yet all in fact are limited by the neighborhood of principles of policy which are other than those on which the particular right is founded, and which become strong enough to hold their own when a certain point is reached. The limits set to property by other public interests present themselves as a branch of what is called the police power of the State.

Hudson County Water Co. v. McCarter, 209 U.S. 349, 355, 28 S.Ct. 529, 52 L.Ed. 828 (1908). It seems quite clear that the extremely important public policy behind responsible self-regulation in the over-the-counter securities market amply justifies the retroactive application of the interpretation in this case. It is important to note in this connection, that the interpretation did not destroy Plaintiffs' withdrawal and reinvestment privileges; it simply denied Plaintiffs the use of the privilege for speculative purposes. Of course, the NASD's power and duty to administer its Rules of Fair Practice were part of the Plaintiffs' investment contracts by operation of law. Plaintiffs surely remember that "contracts must be understood as having been made in reference to the possible exercise of the rightful authority of the Government, and that no obligation of a contract 'can extend to the defeat' of that authority." Norman v. Baltimore & Ohio R. R. Co., 294 U.S. 240, 306, 55 S.Ct. 407, 414, 79 L.Ed. 885 (1935) (Opinion of Justice Hughes in one of the "Gold Clause" cases). As the SEC's "handmaiden", as Plaintiffs put it, and especially since the SEC was so deeply involved in the formulation of the interpretation, we hold that NASD's rulemaking action in this case must be considered a "valid exercise of the rightful authority of the Government;" Plaintiffs will not be heard to complain of NASD's "tortious interference with contract" arising from this quasi-governmental organization's attempt to protect the public from the predatory practices of the Plaintiffs.

IV.

[10] Both Defendants Growth Programs, Inc. and Supervised Investors, Inc. are members of the NASD.[4] As such they are bound by contract with the NASD to abide by all rules, regulations, orders, and interpretations issued to them by the Association. Failure to abide by these directives could, and indeed, according to the Maloney Act, must result in "appropriate discipline" being administered to them by the NASD. 15 U.S.C. § 78o-3(b) (1964). It is obvious—indeed the Plain-

Plaintiffs have failed to exhaust the administrative remedy potentially available to them. See Rosado v. Wyman, 397 U.S. 397, 405, 90 S.Ct. 1207, 25 L.Ed.2d 442 (1970).

4. Although in the view we take of the case the question raised about the relationship between Defendants Growth and Supervised is not particularly important, we do expressly decide that Growth is merely the alter ego of Supervised, and is simply a "tool or business conduit" through which Supervised markets single investment programs like the ones involved in this lawsuit. Thus for purposes of the future of this litigation, if Growth is ultimately held liable, Supervised should be, too.

COPY BOUN

tiffs seem to concede—that Defendants Growth and Supervised cannot be held liable for breaching their contracts with Plaintiffs because they were ordered to do so by the NASD. To hold otherwise would seriously disrupt the statutory scheme of self-regulation established by the Maloney Act.[5]

V.

[11] Plaintiffs' claims that the NASD and its members (including Defendants Growth and Supervised, and a number of the Plaintiffs themselves) violated the antitrust laws, are vague and unsupported. Presumably they base their claim on a concerted refusal to deal theory similar to that in Silver v. New York Stock Exchange, 373 U.S. 341, 83 S.Ct. 1246, 10 L.Ed.2d 389 (1963). This Court agrees with the Defendants, however, that when, as in this case, the NASD is acting in the quasi-governmental rulemaking capacity given to it by the Maloney Act, and is acting under the close supervision of the SEC, it is immune from antitrust suits. This holding seems entirely consistent with the *Silver* case. Indeed, this holding may be compelled by 15 U.S.C. § 78*o*–3(n) (1964), which provides that if any provision of the Maloney Act—including, presumably, the provisions involved in this case authorizing the NASD to promulgate rules designed to "promote just and equitable principles of trade"—is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail." This is precisely the interpretation given this section by the Supreme Court in United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 227, 60 S.Ct. 811, 84 L.Ed. 1129 n. 60 (1940) (Douglas, J., in dictum). Plaintiffs antitrust claims are accordingly found to be without merit.

VI.

There can be no doubt in this case that Section 2(e) of the Plaintiffs' contracts have been breached: Plaintiffs can no longer go "in-and-out" "at any time," as their contracts provide, and as a result, the value of their in-and-out clauses as speculative devices has been destroyed. Plaintiffs have urged this Court to end its analysis there and give them summary judgment. This Court, however, cannot ignore the fact that the reason the contracts were breached was that Defendants Growth and Supervised were following a proper directive of the NASD, the quasi-governmental organization created by the Maloney Act to regulate activity in the over-the-counter securities markets. And, although it is true that many of the class plaintiffs in his suit are not members of the NASD,

> The * * * [NASD's] enforcement of [its] rules inevitably affects the non-member involved, often (as here) far more seriously than it affects the members in question. The sweeping of the nonmembers into the currents of the * * * [NASD's] process of self-regulation is therefore unavoidable.

Silver, supra, 373 U.S. at 356, 83 S.Ct. at 1256 (Justice Goldberg's remarks with respect to the NYSE in this regard are equally applicable to the NASD).

In the final analysis, this Court's answer to the Plaintiffs in this lawsuit must be similar to the comment made by the 10th Circuit panel in Associated Securities Corp. v. Securities & Exchange Commission, 283 F.2d 773, 775 (10th Cir. 1960); namely, that

> In the balancing of injury to * * * [the plaintiffs in this case] and of harm to the public by the proscribed activities in securities transactions

5. By allowing Growth and Supervised the defense of "hiding behind the skirts of NASD," as the Plaintiffs put it, we in no way mean to condone their actions in this affair; it seems clear that, at least initially, they encouraged the abuse of the "in-and-out" privilege by the Plaintiffs. It seems equally clear, however, that granting specific performance of the Plaintiffs' contracts, which would punish only the investing public at large, would not be an appropriate remedy for the Defendants' overreaching, if any there

OUND CLOSE IN CENTER

the necessity of protection to the public far outweighs any personal detriment resulting from the impact of applicable laws.

Plaintiffs' Motion for Summary Judgment is Denied; Defendants' Motion for Summary Judgment are Granted This Memorandum Opinion shall constitute this Court's findings of fact and conclusions of law for purposes of Rule 56, Fed.Rules Civ.Proc.

INTERPRETATIONS AND POLICIES OF THE BOARD OF GOVERNORS REGARDING INVESTMENT COMPANY SECURITIES

¶ 5261 Contractual Plan Withdrawal and Reinstatement Privileges

The Association's Board of Governors is seriously concerned about the growing abuse of the withdrawal and reinstatement privilege extended to investors who buy investment company shares under single-payment and periodic-payment contractual plans.

Generally, such unit investment trusts permit planholders to withdraw up to 90 percent of the current value of their accounts in cash and later to return the money to the account without sales charge.

The withdrawal and reinstatement privilege was designed to permit an investor faced with a genuine financial emergency to withdraw a substantial portion of his investment and later to replace the money (i.e., repurchase shares) without paying an additional sales charge. The convenience was aimed at preserving the planholder's investment, eliminating the need for borrowing on certificates or liquidating his account in an emergency. It originated with contractual plans of the periodic-payment type, where the proportionately higher "front-end load" characteristic of such plans would impose an unusually severe burden on a planholder forced to liquidate to obtain emergency funds.

Single-payment contractual plans were set up within the same framework as periodic-payment contractual plans and the withdrawal and reinstatement privilege was carried over to this method of acquiring investment company shares.

For many years the withdrawal and replacement privilege was used sparingly and for emergencies, as contemplated. Comparatively recently, however, and especially in the last year or so, there has been a sharp increase in both the use of the privilege and the sale of plans carrying the privilege, particularly those plans of the single-payment variety in which substantial sums are initially invested. There has also been a rapid increase in the number of such single-payment plans offered to the public, and certain dealers and certain sponsors are actively encouraging investors to buy investment company shares through contractual plans for the purpose of using the withdrawal and reinstatement privilege for speculative purposes.

These include use of the withdrawn cash for short-term market trading in other securities or repeatedly exercising the privilege, in effect, to play the short swings of the stock market.

For example, if a planholder believes, or his dealer leads him to believe, that the market is due for a downturn, he may withdraw

(Continued on next page.)

Contractual Plan Withdrawal and Reinstatement Privileges—Continued

90 percent of his account in cash. Then if the market goes down, the investor or his dealer will, at a point believed to be the bottom of the downturn, replace the withdrawn cash with the fund underwriter, thus acquiring more shares of the underlying fund than the investor redeemed, and at no sales charge. The planholder can continue this practice as often as he or his dealer thinks the short swings in the market can be predicted.

A booklet recently published by the sponsor of one single-payment contractual plan states:

"Some sponsors have completed arrangements with their Custodian Bank to establish individual Custody Accounts to hold cash that has been withdrawn from Single Investment Plans while awaiting a change in the market before reinvesting. In most cases provision has been made for investing these funds in governments or other short-term investments should the client so desire. . ."

Reinstatement sales alone, i.e., replacement of cash previously withdrawn, in May, 1966, are estimated to have amounted to $100,000,000.

One particular investment company underwent a turnover equivalent to 25 percent of its entire assets during a recent six-month period, as result of planholders withdrawing and putting back cash.

Obviously, this growing practice can cause severe hardships and expense to the underlying investment company and its shareholders by subjecting the investment company to higher than normal redemptions which, in turn, can force management either to liquidate portfolio securities to meet the demand for cash or force the fund to maintain a substantial cash or liquid position without regard to the investment objectives of the fund. In addition, the practice can result in a form of trading against the fund and may result in substantial dilution of the interest of investors in the fund—both those not using the withdrawal and reinstatement privilege and those using the privilege, at least to the extent of their holdings remaining in the fund.

The Board is convinced that this practice is not in the public interest and, to the extent it involves member dealers, sponsors, and underwriters, is contrary to high standards of commercial honor and just and equitable principles of trade. Accordingly, the Board has adopted the following interpretation, effective as of August 1, 1966, regarding all withdrawal and reinstatement privileges, including single-payment, periodic-payment or fully-paid contractual plans:

The Interpretation

It shall be deemed conduct inconsistent with just and equitable principles of trade and in violation of Section 1 of Article III of

(Continued on next page.)

© 1967, Commerce Clearing

Contractual Plan Withdrawal and Reinstatement Privileges—Continued

the Rules of Fair Practice for a member to use or encourage the use of what is commonly known as the withdrawal and reinstatement privilege afforded to planholders under contractual plans, whether single-payment, periodic-payment or fully-paid, in a manner which is detrimental to the interests of the shareholders of the investment company issuing the security underlying the contractual plan. For purposes of this interpretation, practices detrimental to the interests of such shareholders include, but are not limited to the following:

(1.) The suggestion, encouragement, or assistance to (or any arrangement which encourages or assists) a planholder in:

a) making repeated or excessive use of the withdrawal and reinstatement privilege (ordinarily, use of the privilege by a planholder more frequently than once during the period of a year will be viewed as excessive);

b) reinstating the investment within 90 days after withdrawing shares or cash;

c) making use of the withdrawal privilege within six months after the most recent investment in the plan, other than the reinvestment of a dividend or distribution. (This is not intended to interfere with the right of a planholder to liquidate all or a portion of his plan account or to withdraw his shares at any time, but is intended to restrict the use of the reinstatement privilege as to shares or cash which has been withdrawn during the six-month period);

d) using the privilege to provide funds for temporary investment in other securities;

e) using the privilege for the purpose of taking advantage of fluctuations in the net asset value per share of the investment company.

(2.) Any arrangement, or the use of any arrangement, whereby a custodian bank or other person performing a similar function will accept telephone, teletype, or telegraphic requests or instructions for the withdrawal of shares or cash from a plan account, whether such requests or instructions are received from a member or from a planholder.

(3.) Any arrangement, or the use of any arrangement, whereby a custodian bank or other person performing a similar funtion will accept telephone, teletype, or telegraphic requests or instructions, or condition orders, to reinstate shares previously withdrawn from a plan account, whether such requests or instructions are received from a member or planholder.

(4.) Any arrangement, or the use of any arrangement, whereby a custodian bank will withdraw shares or cash from a plan account, or reinstate shares previously withdrawn, upon a power of attorney, executed by a planholder appointing a

(Continued on next page.)

Contractual Plan Withdrawal and Reinstatement Privileges—Continued

member or an associated person of a member, as the attorney of the planholder.

This interpretation is directed primarily to the improper use of withdrawal and reinstatement privileges made available to planholders of contractual plans. However, the principles of this interpretation would also apply to similar misuse of any withdrawal and reinstatement privileges which might be made available to investors in connection with any other acquisition of shares of open-end investment companies.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
CORPORATE REGULATION

November 21, 1967

Mr. Frank J. Wilson
Associate General Counsel
National Association of Securities Dealers, Inc.
888 Seventeenth Street, N. W.
Washington, D. C. 20006

Dear Mr. Wilson:

Your letter of November 9, 1967 requests confirmation of the Commission's action at the time the National Association of Securities Dealers adopted its interpretation on "Contractual Plan Withdrawal and Reinstatement Privileges."

This will confirm our prior advice to you that pursuant to the Commission's authorization of July 18, 1966, we informed the Association on that day that it could proceed with the issuance and publication of the aforementioned interpretation. Also, pursuant to the Commission's instruction, we informed the Association at that time that consideration should be given to indicating in the proposed interpretation that it was applicable to other redeemable shares issued by investment companies, as well as contractual plans. We understand that, in response to the Commission's comment, the Association subsequently added the last paragraph of the interpretation.

A certification of Mr. Orval L. DuBois, Secretary of the Commission, is enclosed. In the certification, Mr. DuBois attests to the excerpt from the Commission's minute of July 18, 1966.

Sincerely yours,

John A. Dudley

John A. Dudley
Associate Director

Enclosure

E-2

UNITED STATES OF AMERICA

SECURITIES AND EXCHANGE COMMISSION

I, Orval L. DuBois, Secretary of the Securities and Exchange Commission, Washington, D. C., and official custodian of the minute books of said Commission, do hereby attest that the following is an excerpt from the Minutes of this Commission dated July 18, 1966, relating to the National Association of Securities Dealers, Inc., more particularly its proposed interpretation with respect to contractual plan withdrawal and reinvestment privileges:.

"With respect to the proposed interpretation of the NASD, the staff was authorized to advise Mr. Robert W. Haack, President, that the NASD could proceed with the issuance and publication thereof but that consideration should be given to indicating therein that it was also applicable to other redeemable investment company shares as well as contractual plans."

Orval L. DuBois
Secretary

November 21, 1967
(Date)

It is hereby certified that Orval L. DuBois, Secretary, Securities and Exchange Commission, Washington, D. C., which Commission was created by the Securities Exchange Act of 1934 (15 USCA Sec. 78a et seq.), is Secretary and official custodian of the minutes of said Commission, and was such official custodian at the time of executing the above attestation.

By the Commission.

Manuel F. Cohen
Chairman

POOR COPY

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

NO. 72-58

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
Petitioner

v.

NORMAN L. HARWELL, et al.
Respondents

RESPONSE OF NORMAN L. HARWELL, ET AL.
TO THE PETITION FOR WRIT OF CERTIORARI FILED BY
NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

TEARL W. LEWIS and
CLARENCE R. BOATWRIGHT
Morriss, Boatwright,
Lewis & Davis
1215 NBC Building
San Antonio, Texas
Counsel for Norman
L. Harwell, et al.,
Respondents

ROBERT A. HEFNER
242 E. Third Avenue
Escondido, California
Counsel for Arthur
A. W. Stanley,
Respondent

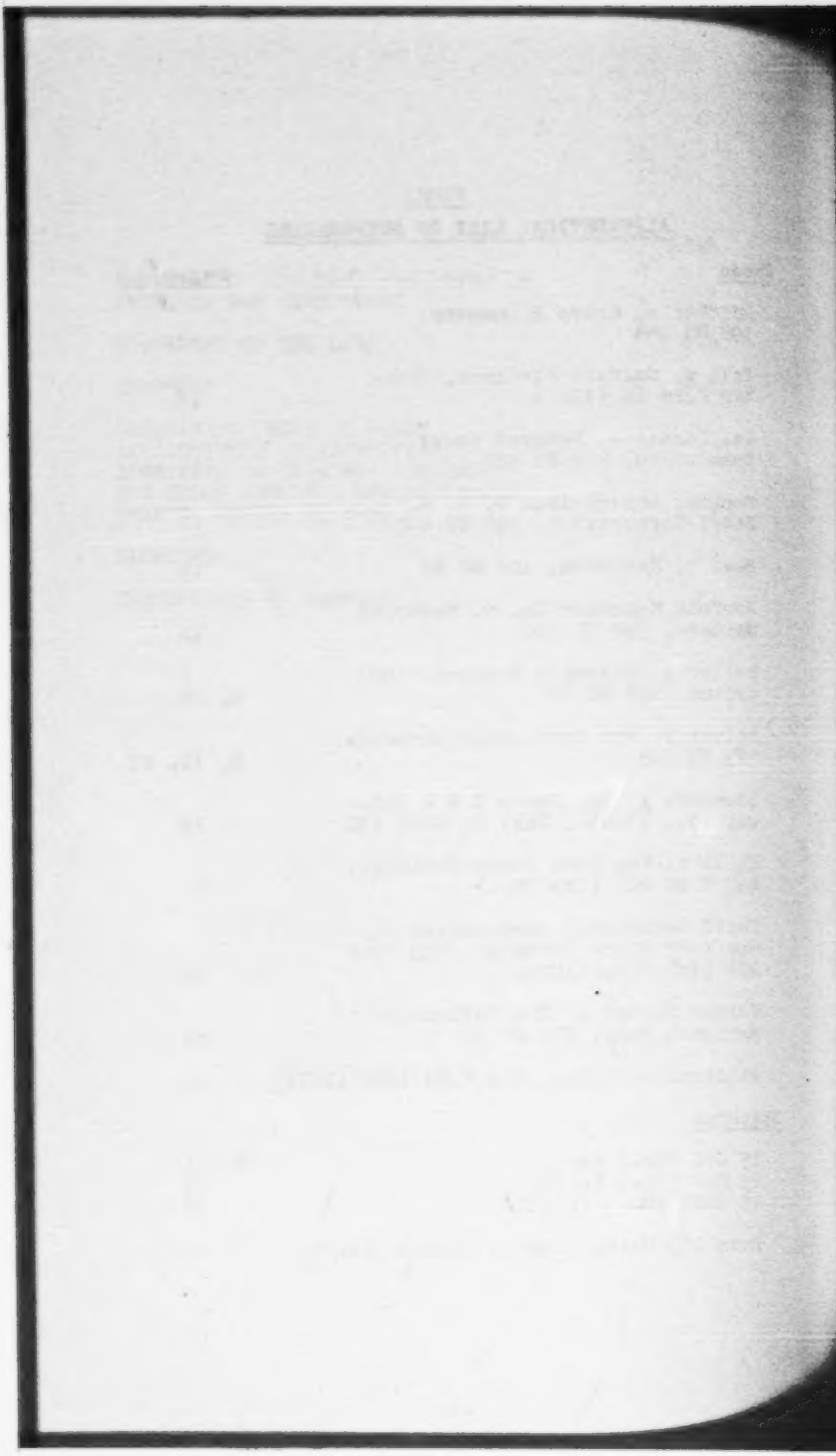
BENJAMIN H. DORSEY
Suite 1106
7910 Woodmont
Washington, D. C.
Counsel for Arthur
F. Luehrs, et al.,
Respondents

INDEX

	Page
ANSWERS TO QUESTIONS PRESENTED IN PETITION FOR CERTIORARI	1-2
STATEMENT OF THE CASE	2-8
ARGUMENT	8-19
SECURITIES INDUSTRY STUDY, SUBCOMMITTEE ON SECURITIES, COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, UNITED STATES SENATE, AUGUST 8, 1972	17-19
SIGNATURES	20
CERTIFICATE OF SERVICE	21

ALPHABETICAL LIST OF AUTHORITIES

Cases	Pages
Adickes v. Kress & Company, 398 US 144	16
Cali v. Eastern Airlines, Inc., 442 F.2d 65 (1971)	16
California v. Federal Power Commission, 269 US 482	12
Fortner Enterprises v. U. S. Steel Corporation, 394 US 495	16
Head v. Hargrove, 104 US 45	19
Norfolk Monument Co. v. Memorial Gardens, 394 US 700	16
Poller v. Columbia Broadcasting System, 368 US 464	9, 15
Silver v. New York Stock Exchange, 373 US 341	8, 11, 13
Simmonds v. St. Louis B & M Railway Co., (S.Ct., Tex) 91 SW2d 232	19
Thill v. New York Stock Exchange, 433 F.2d 204 (7th Cir.)	8
Thill Securities Corporation v. New York Stock Exchange, 433 F.2d 264 (7th Cir.)(1970)	12
United States v. The Philadelphia National Bank, 374 US 321	12
Williams v. Allen, 439 F.2d 1398 (1971)	16
Statutes	
15 USC 780-3 (n)	8, 11
15 USC 780-3 (b)(8)	13
15 USCA 780-3 (k)(1)	14
Rule 19, United States Supreme Court	10



ANSWERS TO QUESTIONS
PRESENTED PAGES 2-4
(PETITION FOR CERTIORARI)

1. With reference to anti-trust immunity--the real question is whether or not the specific act of the petitioner in promulgating what it calls an interpretation of a rule, but which the Court of Appeals suggested might be a new rule, whereby competitive trade in over-the-counter mutual funds was completely eliminated as to all single investment program holders, was an act violative of anti-trust. The question is not whether all actions of the petitioner are immune under the Maloney Act. Furthermore, the Court of Appeals did not decide the question but remanded the cause to the Trial Court to develop the facts in order to ascertain the question of immunity under anti-trust.

2. The Court of Appeals, in setting guidelines for the Trial Court upon the questions of anti-trust involved, followed the guidelines delineated by this Court in Silver vs. New York Stock Exchange, 373 US 341 (1963).

3. The Court of Appeals did not err in applying the standards of Thill Securities Corporation vs. New York Stock Exchange, 433 F.2d 264 (7th Cir.)(1970), because the anti-trust principles applied in Thill are the same principles applied in this Court in Silver and in turn, are applicable in the instant case.

4. In order for the question of anti-trust immunity as to the petitioner to arise, there must be some showing in the record as to what the Securities and Exchange Commission considered in failing to disapprove the alleged interpretation or a new rule promulgated by the petitioner. The very thrust of Section (n) of the Maloney Act with reference to conflict of other laws of the United States presupposes a pervasive supervision by the Securities and Exchange Commission and determination of anti-trust effect upon any act of the petitioner.

5. Since the respondents' suit is one for damages for breach of contract on the part of Growth Programs, Inc. and Supervised Investors Services, Inc., and for specific performance, declaratory judgment and injunction; against the petitioner for tortuous interference with the performance of contract and for violation of the anti-trust laws, the Securities and Exchange Commission is not a forum having jurisdiction, so there was no question of an aggrieved person willfully bypassing administrative procedure and resorting to an action in the District Court, but it was only because

the District Court was the only forum having jurisdiction to determine all questions involved.

6. The Court of Appeals could not have erred in holding that the interpretation was a "new rule" when the wording of the opinion of the Court of Appeals is merely as follows: "We are not persuaded by the NASD arguments that this is not a new rule, but merely an interpretation of an old rule . . ." (Harwell vs. Growth Programs, Inc., 451 F.2d 240, LOC CIT 245). Whether the interpretation is per se an interpretation or is in fact a new rule is a question of fact to be determined later in the Trial Court.

COMPLETE ANSWER TO ALL QUESTIONS PRESENTED IN PETITION FOR CERTIORARI

The Court of Appeals reversed a Judgment of the Trial Court, which Judgment had granted a Motion for Summary Judgment, and remanded the cause for trial on the merits, simply holding many unsettled fact questions existed. The real law question decided by the Court of Appeals was that the Trial Court erred in granting a Summary Judgment. The Court of Appeals was careful in its opinion to say that it was not deciding the various questions petitioner presents in its Petition for Certiorari, and if ever a Petition for Certiorari were premature, the Petition here is so.

STATEMENT OF THE CASE FROM THE RECORD

It is to be remembered that two of the Defendants in the Trial Court, and who were appellees in the Court of Appeals (Growth Programs, Inc. and Supervised Investors, Inc.) have not filed Petitions for Certiorari and, therefore, the Judgment and opinion of the Court of Appeals is final as to them.

Petitioner's statement of the case (pp. 4-13, Petition for Certiorari) is entirely partisan and argumentive and only gives to the Court its contentions and not the true picture of the posture of the case. It is necessary, therefore, for respondents to restate the case.

This suit was filed by the named Plaintiffs (Complaint, App. p. 2; Third Amended Complaint, App. p. 542), and subsequently allowed as a class action (App. p. 514), representing a class of 1258 programholders who were similarly situated with the named Plaintiffs. Plaintiffs sought a declaratory judgment, specific performance, injunctive relief to enforce their vested contractual rights under a contract for which Plaintiffs had paid a valuable consideration, and even a

premium, for what is designated as the "in and out" provision of the contract, and for damages.

The petitioner, NASD, was also a party defendant in the Trial Court wherein respondent sought to have declared void as to them the so-called interpretation made by it and also for damages by reason of its tortuous interference with the performance of the contract between respondent on the one hand and Growth Programs, Inc. and Supervised Investors, Inc., on the other hand, and also by reason of its anti-trust activity wherein petitioner eliminated competitive trading of over-the-counter mutual funds on the part of all of the class respondents.

The named Plaintiffs, and all members of the class, own Growth Program Single Payment Investment Contracts identical to contract shown at Page 23 of the Appendix, except as to names, dates and amounts. Each purchaser paid a premium for his purchase of such contract over and above the face amount of the contract, which premium was for the rights and privileges therein granted to purchaser. One of these was the right and privilege to withdraw and reinvest up to 90% of the shares owned under the contract without charge, i.e., without any brokerage commission or service fee. That provision is paragraph 2 (e), page 2, of said contract, and reads as follows:

> "(e) Partial Withdrawal Without Termination
>
> "At any time after the issuance of this program, the Programholder may without terminating this Program, withdraw part of his Fund Shares, provided such withdrawal shall involve not less than $50.00 of liquidating value and not more than 90% of the Fund Shares standing to his account.
>
> "The Programholder may also make a partial withdrawal and instruct that Fund Shares (within the minimum and maximum amounts set forth above) be liquidated and the applicable net proceeds remitted to him in cash. Upon the receipt of such written instructions the Shares shall be withdrawn from the Custodianship and the Custodian shall effect such liquidation and remit the net proceeds less deductions authorized hereunder.
>
> "If the Programholder has made a partial

withdrawal and caused Fund Shares to be liquidated and the proceeds remitted to him, he may at any time thereafter pay to the Custodian, in cash, up to the same dollar amount received by him in connection with such partial withdrawal and liquidation and have the same applied to the purchase of Fund Shares at their then net asset value. If the Programholder has made a partial withdrawal and received certificates for Fund Shares, he may, at any time thereafter, restore in kind up to the same number of Fund Shares so withdrawn."

These contracts were sold on the basis of promotional literature and prospectuses emphasizing the unlimited use of the withdrawal and reinvestment privilege. See Chorn's deposition, Exhibits 58 through 65, 76 through 86 (with sub-referenced Exhibits).

References to specific parts of said Exhibits and summary excerpts relevant to this point from some of the above quoted Exhibits are:

1. Px 62, Chorn's deposition, being prospectus of Program Company dated April 30, 1965, for Single Investment Programs only, page 4, paragraph (3), provides unlimited partial withdrawal without termination up to 90%, without brokerage commission or service fee for restoration, and Programholders' right to operate through his dealer.

2. Px 63, Chorn's deposition, prospectus of Program Company dated April 30, 1965, page 5, paragraph (3), provides unlimited withdrawal and reinvestment privileges without commission or service charges, and further provides for orders through the Programholders' dealer.

3. Px 64, Chorn's deposition, prospectus of Program Company dated April 26, 1966, page 7, paragraph (3), provides unlimited withdrawal and reinvestment privileges as theretofore without commission, but provides for a service charge of $2.50 for each partial withdrawal or liquidation, but no service charge to be made in connection with reinvestment; further provides the actions to be taken through the Programholders' dealer.

4. Px 65, Chorn's deposition, prospectus of Program Company dated April 26, 1966, page 3, paragraph (3), provides unlimited withdrawal and reinvestment privileges as theretofore without commission,

but provides for a service charge of $2.50 for each partial withdrawal or liquidation, but no service charge to be made in connection with reinvestment; further provides the actions are to be taken through the Programholders' dealer.

5. Px 78, Chorn's deposition, is the brochure, "Single Investment Programs for the Executive Investor" (referred to by Mr. Chorn as the "executive kit"), (also at App. p. 116-193). On the inside of the front cover, it contains advertising of the "'in and out' privileges without payment of any brokerage commission - any service fee!" and states "Furthermore, you can exercise your rights of withdrawal and reinvestment any time you wish . . . for a period of 30 years from the date of your original investment." The kit contains Television-Electronics Fund prospectus of March 1, 1965; Growth Programs, Inc. prospectus of April 30, 1965; and Television-Electronics Fund semi-annual report for April 30, 1965.

6. Px 79, Chorn's deposition, is the brochure, "Single Investment Programs for the Executive Investor." Inside of folder cover contains the same large advertising spread on the "in and out" privileges with only one addition: "without payment of any brokerage commission - only $2.50 service fee!" The kit further contains prospectus for Single Investment Programs dated April 26, 1966; prospectus of Television-Electronics Fund dated February 23, 1966; semi-annual report of Television-Electronics Fund dated April 30, 1966; and a brochure on Growth Programs, Inc. disbursement accounts. Page 3 of the prospectus for Single Investment Programs, paragraph (3), (App., bottom of p. 126), contains the full description of partial withdrawal and reinvestment privileges through the dealer, changed from prior prospectuses only by the addition of the $2.50 service charge for each partial withdrawal.

7. Px 80, Chorn's deposition, is the same as Px 79 above, but the inside of the front cover, instead of having reference to the service fee in italics, contains a gold-colored label pasted on. All other wording is identical with prior Executive Kits with minor revisions on enclosures.

8. Px 80, Chorn's deposition, (duplicate number being letter immediately following the Executive Kit, Px 80), emphasizes unlimited withdrawal and reinvestment privileges without sales charge, without brokerage commission, but only the service fee ($2.50), and emphasizes also the 30-year period for which the contract is written.

9. Px 81, Chorn's deposition, a brochure emphasizing the "in and out" privileges without commission; and the "in and out" privileges were required to be exercised through the Programholders' dealer (Chorn's deposition, p. 334).

10. Px 85, Chorn's deposition, "The Big Sale" written by James R. Lewis, President of Growth Programs, Inc., emphasizes the 90% "in and out" privileges (pp. 2 and 3), use of telephone orders (p. 7), long life, 30 years (p. 8), simplified procedures for withdrawals and reinvestment (p. 10), and Conclusion (p. 11).

The contractual plans themselves, and the prospectuses referred to therein, were registered with the Securities and Exchange Commission under the Securities Act of 1933, (App. p. 221, Chorn's deposition, p. 508, and registration statements on each prospectus). The contractual provisions respecting the unlimited use of the withdrawal and reinvestment privilege was emphasized in all sales literature and prospectuses, and constituted a major consideration for the purchase of such plans. All of these plans which were owned by named respondents, and members of the class, were purchased before January 1, 1966. Thereafter, a supplement dated January 17, 1966, was added to the prospectus giving the sponsor, Growth Programs, Inc., the right to limit withdrawals to four times a year. (Chorn's deposition, Px 63, sticker on p. 5). Subsequently, the sponsor, on June 20, 1966, did exercise its right under the addendum to limit withdrawals to four times a year to those contracts sold after January 17, 1966. (Chorn's deposition, Px 117).

It is undisputed that Growth Programs, Inc. and Supervised Investors, Inc. violated their contract with the respondents to respondents' great damages. Growth Programs, Inc. and Supervised Investors, Inc. defended such breach by hiding behind the cloak of petitioner, and all three parties defendant in the Trial Court, and as appellees in the Court of Appeals, made common defense against these respondents. It was not until Petition for Rehearing in the Court of Appeals that the petitioner sought a judicial divorce from Growth Programs, Inc. and Supervised Investors, Inc.

ADDITIONAL ERRORS MADE BY PETITIONER IN STATEMENT OF THE CASE

As stated at the beginning of this Statement of the Case, petitioner in its statement (pp. 4-13) has made many statements as if they were conclusive and

without dispute. Respondents desire to challenge such statements principally upon the grounds that there has been no determination of the facts and that there are no facts as a matter of law which have not been or will not be disputed.

At page 2 (all references are to Petition for Certiorari unless otherwise noted) the petitioner used the term "misuse" of the withdrawal and reinvestment privilege as if there has been a judicial determination but there had been "misuse" whereas such alleged misuse is disputed and is a question of fact that has never been determined. However, throughout petitioner's Petition, it assumes a misuse but such assumption is not founded upon any proven fact.

Again at page 7 petitioner again refers to the alleged misuse of the privilege and denominated it as a speculative detriment to 110,000 shareholders who did not possess the privilege. It never has been determined as to whether or not the use of the privilege by the respondents caused any detriment to the other 110,000 shareholders in the mutual fund and such alleged detriment is a question of fact yet to be determined. This is also true of a claim of dilution. At bottom of page 7 petitioner makes the statement that "this dilution has never been denied . . ." Such statement is wholly untrue and has numerously been denied and is a fact question yet to be determined upon a trial of the merits.

Again at page 8 petitioner consistently uses the term "misuse of the privilege." There has been no determination of misuse and petitioner's continued use of this term throughout its Petition is most misleading and not based upon fact. At page 10 petitioner continues to use the terms "misuse" and "dilutive effects" as if such were facts which had been established by competent proof. Petitioner attempts to assume the position of a "guardian angel" of some 110,000 investors and there has been no proof and no established fact that there is any need for any guardian angel.

In truth and in fact, the petitioner, a private corporation incorporated under the laws of the State of Delaware, pursuant to the terms and provisions of the Maloney Act, is so monopolistic that every security dealer in the United States must be a member of it in order to do business. As a prerequisite of becoming a member of petitioner, each applicant for membership is required to sign a contract with petitioner waiving any right to sue petitioner for any cause, whereupon the petitioner becomes a "hard nosed task master" holding the whip over all of the security

dealers in the United States under the guise of requiring fair practice in the securities industry. With such monopolistic power the petitioner promulgated what it calls an interpretation of its rule, but what respondents believe to be a new rule as suggested by the Court of Appeals, requiring Growth Programs, Inc. and Supervised Investors Services, Inc. to cease and desist aiding the respondent, Harwell, et al., in the exercise of an absolute contract right. The threat held over the heads of Growth Programs, Inc. and Supervised Investors Services, Inc. was either disciplinary action against them or even expulsion from the Association. This arbitrary and coercive act taken by the petitioner is what it is asking a court of justice to sanction. This act on the part of this petitioner operated not only as a partial restraint of trade but operated as a total elimination of free trade in over-the-counter securities on the part of the respondents. This is the type of action petitioner is asking a court of justice to throw the cloak of immunity around and exempt it from the anti-trust laws.

ARGUMENT

Petitioner, National Association of Securities Dealers, Inc. (NASD), the only appellee petitioning for a writ of certiorari, complains that the Court of Appeals wrongly concluded:

> "But it does not follow that NASD and its members are immune from anti-trust attack on all of their activities, and neither the NASD nor the SEC to argue.***"
>
> ******
>
> "The Court must determine when the NASD is immune from anti-trust penalty in acting in its rulemaking capacity. ***"

Petitioner's complaint is bottomed on two contentions:

(a) A section of the Maloney Act (15 USC 780-3 (n)) wraps the conduct of NASD as an impregnable shield of anti-trust immunity. cf. Thill v. New York Stock Exchange, 433 F.2d 204, 269.

(b) The Court wrongly applied the teaching of Silver v. New York Stock Exchange, 373 US 341.

Petitioner has not asserted any of the usual standards governing the grant of petitions for certiorari

except to say that whether the Maloney Act cloaks petitioner with specific anti-trust immunity is an "important question of federal law (that) has not been, but should be, settled by this Court," Pet., p. 3; and that the decision of the court below conflicts with Silver, supra. The other four points advanced by petitioner are really only ramifications of this dissatisfaction with the holding of the court below with regard to the above two basic propositions.

The District Court disposed of the case by summary judgment, holding "that the NASD interpretation questioned by the plaintiffs is clearly within the power granted the NASD by the Maloney Act; that it was issued pursuant to proper procedure; and that it is reasonable. That is all this Court need decide," Pet. App., p. C-6. The Court of Appeals reversed and remanded "on the grounds that this case was not disposed of properly by summary judgment. There are difficult issues which can be determined only after a trial on the merits. *** It is not our intention by this decision to make any final determination of those questions. It seems inappropriate to try to determine the precise rules which should be applied until the case has been heard on the merits, the facts have been fully developed and the trial judge has made the difficult reconciliations required on the evidence presented," Pet. App., p. A-1. It is almost axiomatic that cases involving the application of the anti-trust laws to complex situations are not best disposed of on the skeletal framework of summary judgment. Poller vs. Columbia Broadcasting System, 368 US 464. This case is not yet ripe for the consideration of the Court.

With regard to the sweeping anti-trust immunization effect of (h) of the Maloney Act, petitioner equates "any provision of this section" with its interpretation of one of its own rules. It requires no great effort in statutory construction to show that such a tortured reading of sub-section (n) is desperately sophistical in its attempt to justify a per se violation of the anti-trust laws. No section of the Securities Exchange Act permits NASD to institute a group boycott depriving members of the public of their contractual rights.

Petitioner's disagreement with the Silver doctrine--that the provisions of the Securities Exchange Act prevail over the anti-trust laws when the provisions of the two laws are in conflict and then only to the minimum extent necessary to resolve such conflict--points out its dilemma. There is no provision of the Maloney Act which is here in conflict with the

group boycott required by NASD but forbidden by the anti-trust laws. Petitioner has tacitly admitted that its group boycott action effectively foreclosed respondent from exercising its contractual rights, and in justification, as the Court of Appeals held:

> "It is noted that NASD has argued that the case is largely, if not completely, moot because a key ingredient in the successful exercise of the privilege was the method of computation of price. This has now been changed by action of the NASD, the SEC, and the custodial bank of Technological Fund, Inc., the underwriting mutual fund of Growth. The facts concerning this argument must be considered in determining whether it was the privilege itself which was contrary to public interest, or the price method by which it could be used. Plaintiffs had no contractual rights to this pricing method." Pet. App. p. A-4.

Petitioner could have caused the method of computation of price to be changed but elected the group boycott instead. The reason for this choice and the damage to respondents can only be developed at a trial on the merits.

Silver is not in conflict with the holding of the court below, which is the logical and harmonious application of the Silver doctrine to NASD's anti-competitive actions herein.

PETITIONER'S APPLICATION FOR WRIT OF CERTIORARI IS IMPROPER IN THAT IT FAILS TO COME WITHIN THE SCOPE AND GUIDELINE OF RULE 19 OF THIS COURT.

This Court has set certain standards and guidelines for granting Writs of Certiorari in Rule 19. A review on Writ of Certiorari is not a matter of right, but of sound judicial discretion and will be granted only where there are special and important reasons therefor. In respect to decisions by a Court of Appeals, Rule 19 states that this Court will consider granting a Writ of Certiorari where the Court of Appeals, "...has decided an important question of federal law which has not been, but should be, settled by this court." (emphasis added)

Petitioner argues that the question of whether the petitioner is cloaked with specific anti-trust

immunity under 15 USC 780-3 (n) should be decided by this Court. At no time does the petitioner claim nor can it, that the Court of Appeals has decided said question.

The Court of Appeals has done nothing more than remand the case to the District Court for further proceedings. The Court of Appeals stated it made no "final determination" of the question involved, but petitioner attempts to side-step this fact by stating that the Court of Appeals misconstrued the law and therefore the case should not go back to the District Court but should be heard on all issues by this Court. This "bootstrap" argument would result in this Court hearing matters and deciding issues which were never presented or heard at the District Court level. In effect, the guidelines set forth in Rule 19 would be obviated if the argument of petitioner is accepted.

Petitioner then asserts that a conflict exists with the decision in Silver vs. New York Stock Exchange, 373 US 341 (1963). A reading of petitioner's argument in this regard reveals different facts between this case and Silver. In Silver, the question was whether the New York Stock Exchange was subject to anti-trust laws and did not concern the National Association of Securities Dealers, Inc. Petitioner concedes that the Maloney Act was not involved in Silver and proceeds to quote language from Silver which "focuses upon the primary distinction between this case and Silver." Any so-called "conflict" is derived by petitioner from dicta and a statement by the Court in Silver that it was "an issue we do not decide today."

This, it is submitted, does not come within the standards set forth in Rule 19 which calls for a decision by the Court of Appeals which conflicts "with applicable decisions of this Court." (emphasis added)

Thus, it is respondents' position that this is not a case which comes within the purview of Rule 19 of this Court. The respondents are willing to submit this matter, in its entirety, to the District Court and not proceed piecemeal as the other parties (Growth Programs, Inc. and Supervised Investors Services, Inc.) are still waiting in the wings to proceed with the litigation in the District Court. The petitioner may wish to divorce itself from its co-defendants but it is submitted that this Court should not assume the task of deciding whether to dissolve the marriage. This, it is submitted, is the task of the District Court as stated by the Court of Appeals.

It is elementary law with no need to cite the

authority that jurisdiction to review by certiorari in the Supreme Court of the United States is always sparingly exercised and is exercised only in cases of peculiar gravity and general importance, or in cases affecting relations with foreign governments or to secure uniformity of decisions. Furthermore, there is no constitutional question in the case at bar in its present posture.

It is to be borne in mind that the Court of Appeals in its Opinion has not made a final determination with reference to the anti-trust laws as being applicable to NASD, but has given guidelines to the District Court with reference to anti-trust upon a trial of this case on its merits. The question of anti-trust liability should be left to the determination by the District Court after the facts have been fully developed. As well stated in Thill Securities Corporation vs. New York Stock Exchange, 433 F.2d 264 (7th Cir.)(1970) that "most important, before a Court may abdicate its jurisdiction on the anti-trust issue, the defendant must establish its anti-competitive conduct as justified because it is necessary for the operation of the Securities Act," and further, "on the other hand, it should be remembered that the Courts of the United States have over the years become the repository of anti-trust expertise."

All through the years, the Federal Courts, and particularly the Supreme Court of the United States, have been most jealous in maintaining jurisdiction relating to anti-trust. Anti-trust is so firmly established in our Federal jurisprudence that immunity therefrom is to be most strictly construed. And such immunity from anti-trust laws is never to be lightly implied. California vs. Federal Power Commission, 269 US 482, 82 S.Ct. 901, 8 L.Ed2d 54. Respondents would urge upon this Court most careful consideration of the California case, supra, and United States vs. The Philadelphia National Bank, 374 US 321, 83 S.Ct. 1715, 10 L.Ed2d 917. It would lengthen this answer beyond permitted limits to quote extensively from the Opinions in California and Philadelphia, but the teaching of each case is most helpful in resolving the anti-trust questions in the case at bar.

The Philadelphia case was a suit for injunction by the United States to restrain a bank merger which had been attempted under the Bank Merger Act of 1960, and which merger had been approved by the Federal agency to which Congress had delegated the authority of either approving or disapproving bank mergers. The same contention was made by Philadelphia bank as

is made by NASD in the case at bar, but such contention was rejected by the Supreme Court in the following strong language: "Repeals of anti-trust laws by implication by a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy by the anti-trust and regulatory provisions." (Local Citation 937). Philadelphia also answers any question with reference to the doctrine of "primary jurisdiction," holding it inapplicable, and under the analogy here, is likewise inapplicable.

It is somewhat difficult for respondents to understand the partisan position taken by SEC in this case because under the Securities Exchange Act, SEC has the bounded duty to protect investors, such as respondents, but apparently forsaking such duty, SEC has sought to sustain the position taken by NASD, the latter being a monopolistic corporation, being the only one of its kind in the United States, and to which organization every broker-dealer in America must belong, for economic reasons if for none other. The language of the Court of Appeals in Thill appears somewhat pertinent in that connection wherein that Court said, "Rather, it seems to demonstrate that shortly following the establishment of administrative procedures the regulatory agency usually become dominated by the industry which it was created to regulate." (Local Citation 273).

Thill specifically holds that the Congress did not intend to exempt the securities industry from anti-trust liability when it passed the Securities Exchange Act.

As held in Silver vs. New York Stock Exchange, 373 US 341, 83 S.Ct. 1246, 10 L.Ed. 2d 389, anti-trust liability attaches where facts are sufficient to support anti-trust liability unless there is statutorily authorized all pervasive supervision of the conduct by a regulatory agency, and that to enforce the anti-trust, the statute creating the regulatory agency would be annulled as to its supervision. As stated by the Court of Appeals, there is no specific anti-trust immunity granted to NASD under the Maloney Act.

The Court of Appeals stated that the Maloney Act explicity provides that the Commission is to consider anti-trust effect in connection with the rules of NASD, and cites 15 USC Sec. 780-3 (b)(8). However, upon a careful reading of the cited section of the Maloney Act, it is only provided that the rules of the association were to be designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of the trade, etc. But it is respectfully submitted that such section

does not, nor does any other section of the Maloney Act, expressly direct that SEC shall have supervision, much less pervasive supervision of the effect of the anti-trust laws upon the rules of NASD. It is very easy to imagine many, many fraudulent and manipulative practices which would in no wise violate anti-trust. This is to say that merely supervision of fraudulent and manipulative practices is not the same as anti-trust. Nowhere does the Maloney Act authorize SEC to promulgate rules of NASD, but on the other hand, the only authority in the Maloney Act granted to SEC with reference to rules of NASD is contained in 15 USCA 780-3 (k)(1) et seq. It is specifically to be noted "The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated." A mere reading of the "matters hereinafter enumerated" in no wise refer to anti-trust effect in the matter of alteration or supplement to rules. In short, "the matters hereinafter enumerated" refer to the internal organization and management of NASD, but in no wise refer to the rules and regulations of NASD as applicable to third parties, such as respondents.

In connection with the anti-trust feature, the holding of the Court in Thill, supra, is quite apposite wherein that Court held as follows:

> "In the record before us there is no evidence, save for the allegations of plaintiff, as to the effects of the anti- competitive conduct complained of; there is no evidence as to the extent to which the challenged rule is subject to actual review by the SEC; there is no evidence as to what in the regulatory scheme 'performs the anti-trust function'; and, most notably, there is no evidence as to why the anti-rebate rule (NASD interpretation) (ours) must be preserved as 'necessary to make the Securities Exchange Act work.' In sum, the record falls woefully short of the meticulous analysis called for in Silver."

Due to the ubiquitous searchlight always held at the ready by our anti-trust laws, all business transactions are at least subject to inquiry to determine whether or not there has been infraction of anti-trust.

Obviously, NASD does not approve of Silver, supra, and it would prefer being absolutely excused

from any anti-trust liability so long as it talked over its course of conduct with the SEC and received the comfort of a Commission Minute not disapproving the NASD's proposed action.

The NASD is, among other things, a trade association in the securities field. Because of power politics within its organization, there are doubtless actions it may consider taking where it would like to be completely free of any anti-trust liability. If such could be accomplished by informal consultation with the SEC staff and failure to disapprove recommended action by the Commission, NASD would achieve an immunity from the anti-trust laws that might be totally inconsistent with the public interest as expressed by the anti-trust laws and the Supreme Court of the United States.

The factual desert that NASD glosses over in this connection may be observed by the fact that it quotes extensively from the Ratzlaff deposition and mentions three persons from the SEC staff who took part in a number of these meetings. It is not disputed that there are no affidavits from the three named Commission personnel concerning these meetings, that Ratzlaff was not a negotiator for the NASD, and that Ratzlaff cannot remember all the people who took part in the meeting. We do not know whether the NASD was concerned primarily about how other competitive mutual funds felt about the "in and out" privilege, or what it told the SEC staff in this regard. Ratzlaff is absolutely silent on the question of whether or not the anti-competitive aspects of the proposed "interpretation" were considered by the NASD staff or the SEC staff, or either of them. Further, there is absolutely no showing of what the SEC staff told the Commission with regard to the anti-trust aspects of the matter. There is also no showing that the NASD or the SEC considered the position of petitioner or Growth Programs; if this is, as NASD says, "a classic case of SEC supervision," then we may be certain that absolutely no consideration was given to any facet of the anti-trust laws, and it is no supervision at all in the anti-trust sense. Only facts developed at trial can shed light on these dark corners.

SUMMARY JUDGMENT AND THE ANTI-TRUST LAWS

The standard to be followed concerning the use of summary judgment in anti-trust cases has been set forth in Poller vs. CBS, 368 US 464, 7 L.Ed. 458 (1962):

"Summary judgment should be entered only

> when the pleadings, depositions, affidavits, and admissions filed in the case 'show that (except as to the amount of damages) there is no genuine issue as to as material fact and that the moving party is entitled to a judgment as a matter of law.' Rule 56 (c), Fed. Rules Civ.Proc. This rule authorizes summary judgment 'only where the moving party is entitled to judgment as a matter of law where it is quite clear what the truth is, . . . (and where) no genuine issue remains for trial . . . (for) the purpose of the rule is not to cut litigants off from their right of trial by jury if they really have issues to try.'" pg. 468.

The Poller doctrine has been cited with approval in Fortner Enterprises vs. U.S. Steel Corp., 394 US 495, 22 L.Ed. 495 (1969) which quoted the following holding in Poller with approval:

> "We believe that summary procedures should be used sparingly in complex anti-trust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators and hostile witnesses thicken the plot. It is only when the witnesses are present and subject to cross-examination that their credibility and the weight to be given their testimony can be appraised. Trial by affidavit is no substitute for trial by jury which so long has been the hallmark of 'even handed justice.'" pg. 500.

The Supreme Court again, and in its most recent holding on the applicability of summary judgment to anti-trust cases, restated the Poller doctrine with approval. Norfolk Monument Co. vs. Memorial Gardens, 394 US 700, 704, 22 L.Ed.658, 662 (1970).

The movant for summary judgment must also show the absence of any material factual issue for trial. Adickes vs. Kress & Co., 398 US 144, 26 L.Ed.142 (1970); Cali vs. Eastern Airlines, Inc., 442 F.2d 65 (1971). Poller has been cited with approval. Williams vs. Allen, 439 F.2d 1398 (1971).

"SUPERVISION" BY SEC OF NASD OR SECRET, INFORMAL BARGAINING

In a report of a Securities Industry Study, had before the Subcommittee on Securities Committee on Banking, Housing and Urban Affairs, United States Senate, dated August 8, 1972, the relationship between Securities and Exchange Commission and the petitioner herein was given careful and thorough study and particularly with reference to the National Association of Securities Dealers Automated Quotation System (NASDAQ).

The controversy arises out of whether or not stocks listed on the stock exchanges should be included in the Automated Quotation System of the petitioner. Obviously the exchanges oppose the inclusion of listed securities on the Automated Quotation System but that the Securities and Exchange Commission has given its letter of non-disapproval of an amendment of a rule to the petitioner.

The study reveals that "...representatives of the NASD were previously advised informally by the Division of Trading and Markets that significant antitrust questions might be involved in any attempts to exclude exchange-listed securities from the NASDAQ system . . ." SEC did not inform NASD Board of Governors of its reservations until much later. (page 6, Senate report).

The questions being considered by the Senate Subcommittee were various but three principal questions by the Committee are as follows:

--Are self-regulatory organizations in a position to reach fair and constructive decisions on questions which involve largely economic issues between different classes of members, or between members and non-members?

--Should the NASD "promote" the interests of the over-the-counter market in competition with exchange markets, in the same manner as the exchanges "promote" the interests of their markets?

--If so, to what extent should firms whose principal economic attachment is to the exchange markets be permitted to participate in decisions involving inter-market competition?

The Committee report continues as follows:

"The SEC's action in 1968-70, first preventing the NASD from excluding listed securities, and then acquiescing in such exclusion, were products of the 'informal bargaining process' which has generally characterized the SEC's relationship with the self-regulatory agencies. Not only was there no public hearing, but at no point during the entire period was a public statement made that the Commission had made a decision on the issue--much less what the decision was, when it was made, and what it was based on. The staff, in its communications with the NASD, repeatedly referred to positions as those of the 'Commission.' However, a new Chairman in 1970, who had been a member of the Commission throughout the period, was reported to have said that it was only the staff that had opposed the NASD's proposal to exclude listed securities."

It thus appears that the Congress is becoming most interested in the relationship between the Securities and Exchange Commission and the petitioner, especially with reference to the rulemaking power of the petitioner, and also the question of anti-trust effect.

FACT ISSUES PRECLUDING SUMMARY JUDGMENT IN BEHALF OF NASD

This Court of Appeals in its Opinion, has stated a number of fact issues all of which preclude summary judgment in behalf of NASD. We here list in a general way issues of fact which are raised under the various motions and pleadings of the parties:

1. Facts as to whether or not the retroactive effect of the NASD "interpretation" is reasonably necessary to protect public interest.

2. Facts as to whether or not there was a public interest sufficient to require a retroactive application of the "interpretation."

3. Facts as to what approval, whether by SEC or NASD, was had with reference to the unlimited "in and out" privilege.

4. Whether in fact the activities of the respondents did constitute an illegal abuse of such privilege, or caused any dilution of the equity ownership of other shareholders. NASD labors this question and refers to the mathematical calculations and opinion of NASD' chief economist, Mr. Ralph E. Burgess.

At best, such evidence would only constitute an opinion of Mr. Burgess, and opinion evidence is never conclusive. It only raises a fact issue. Head vs. Hargrove, 104 US 45, 26 L.Ed. 1028; Simmonds vs. St. Louis B & M Railway Company, (S.Ct., Tex) 91 SW2d 232.

5. Facts as to whether or not there was administrative due process to the respondents and particularly the respondents who are not members of NASD.

6. Facts as to whether or not it was the "in and out" privilege which was of itself contrary to public interest, or whether it was the pricing method which was permitted to be used.

7. Facts as to what supervision was exercised by SEC in the promulgation of the "interpretation" by NASD.

8. Facts upon which analysis could be made as explained in Silver, supra, to determine whether or not the purpose of the Securities Act can properly function if the anti-trust laws are applied to NASD making the interpretation in question.

9. Facts so as to determine whether or not there is an immunity from anti-trust in the making of the "interpretation," which immunity must be based upon an analysis of the workings of the Securities Act and the anti-trust laws. In short, are the purposes and workings of the Securities Act and anti-trust in connection with the making of the "interpretation" repugnant to one another.

10. Facts upon which the Court may determine whether or not NASD is immune from anti-trust penalty in making the rule in the case at bar.

11. Facts to determine the exact supervision of SEC over NASD in making the particular interpretation involved, and particularly as to whether or not the anti-trust aspect was considered at all.

There could be no doubt that enforcement of the NASD "interpretation" or new rule, whatever it is, directly restrains free trade in line of commerce as those terms have been judicially defined under the anti-trust laws.

CONCLUSION

WHEREFORE, it is prayed that the Petition for

Writ of Certiorari be and in all things denied.

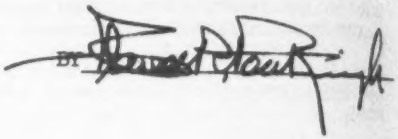
Respectfully submitted,

TEAIRL W. LEWIS

CLARENCE R. BOATWRIGHT

BENJAMIN H. DORSEY

ROBERT A. HEFNER



CERTIFICATE OF SERVICE

I, Clarence R. Boatwright, counsel for Norman L. Harwell, et al., respondents herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that, on the 25th day of August, 1972, I served three (3) copies of the foregoing Response to Petition for Writ of Certiorari to the Supreme Court of the United States on the several parties thereto as follows:

1. On National Association of Securities Dealers, Inc., petitioner, by mailing three copies in duly addressed envelopes, with air mail postage prepaid, to their attorney of record as follows:

To Lloyd J. Derrickson, Esq. and Frank J. Wilson, Esq., 1735 K Street, N.W., Washington, D. C. 20006 and Joel H. Pullen, Esq. at Davis, O'Connor & Pullen, 1515 National Bank of Commerce Building, San Antonio, Texas 78205, Attorneys for National Association of Securities Dealers, Inc.

2. On Growth Programs, Inc. and Supervised Investors Services, Inc., appellees below, by mailing three copies in duly addressed envelopes, with postage prepaid, to their attorneys of record as follows:

To Lionel R. Fuller, Esq. and James D. Baskin, Jr., Esq., Attorneys for Growth Programs and Supervised Investors Services below, at Matthews, Nowlin, MacFarlane & Barrett, 1500 Alamo National Building, San Antonio, Texas 78205.

3. On the Securities and Exchange Commission, amicus curiae below, by mailing three copies, in a duly addressed envelope to G. Bradford Cook, Esq., its General Counsel, at the offices of the Commission, Washington, D. C. 20549.

It is further certified that all parties required to be served have been served.

Clarence R. Boatwright
1215 National Bank of Commerce Building
San Antonio, Texas 78205